PARTIAL DIFFUSION AND BACKSLIDING IN INTERNATIONAL STANDARDS

BY

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DISSERTATION

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Abstract

Built through international efforts and agreements, international accounting standards are the foundation that supports cross border investment. These standards are political and, as with other areas of international capital regulation, are built through a mix of public and private bodies. Yet, despite nearly sixty years of efforts, the international community has not produced a consistent set of standards. Researchers have attempted to explain this failure through theories of power (economic and other) as well as with theories of political ties and legal systems (Eaton 2005; Eberle & Lutz 2008; Posner 2009 & 2010; Ramanna & Sletten 2009; Simmons 2001; Veron 2007). These theories have been inadequate and sometimes empirically wrong in explaining and predicting the politics and spread of International Financial Reporting Standards (IFRS).

One reason why these theories have been inadequate is that they have failed to account for the partial and incomplete nature of typical agreements on international accounting standards. For example, despite an agreement of complete convergence, China and the EU have only selectively applied some international accounting rules to various sectors of their economies. Taking partial cooperation into account not only helps explain accounting standards but has implications for studies of international cooperation more broadly

I posit cooperation on these financial agreements, which is often partial and incomplete, can be explained by the role of private regulators in setting international standards. This contrasts with Drezner's (2007) theory that great powers are responsible for international regulatory outcomes, and with Fioretos' (2010) argument that international regulatory outcomes are a product of historical institutionalism. The interaction among governments and

transgovernmental actors has been widely studied regarding similar capital regulation, but I approach IFRS differently by analyzing private regulators' interactions with governments and firms. For this analysis, I have built an original dataset of international accounting standards agreements from 1980 to 2016 that assesses the level of cooperation between countries and how private regulators are involved.

To explain the unique international issues surrounding financial standards, I develop three models or lenses: A Prisoner's Dilemma model, a coordination model, and a compliance model. Chapter two discusses the cooperation model and how countries initially move toward one standard among several. My main argument is economic imbalances push countries away from cooperation on financial rules. I posit capital exporting countries want transparency while capital importing countries would like to use more obscure financial rules to gain a competitive advantage. This asymmetry between countries tends to move them towards partial cooperation. The results from my quantitative and qualitative analyses support these claims.

Chapter three discusses the coordination model and how countries selectively apply international financial agreements to avoid their application to some sectors or firms. Furthermore, I examine the distributional consequences stemming from this process. My main argument in this chapter is that countries would like to maximize gains by applying international agreements to industries that will benefit while shielding those that will lose. This makes the international agreement less meaningful since its purpose it to cross-border comparability of firms. I find dependence on foreign creditors or international markets determines which sectors governments and private regulators choose to adhere to international standards. The results using my original dataset support these claims.

Chapter four discusses the compliance model and explains the differing rates of compliance. There are three main compliance problems: (1) political independence of private regulators, (2) financial independence of private regulators, and (3) the disconnect between private bodies and government bodies in terms of their understanding of what can be accomplished when agreeing to IFRS. I use a combination of case studies and quantitative analysis to demonstrate how these issues impact compliance of international financial agreements.

I conclude with a discussion on how these lens can be used together and how anticipated international compliance shapes both cooperation and coordination. Furthermore, I give a summary of how this project fits in the context of other analyses of the political problems plaguing IFRS and similar international regulatory agreements.

In Memory of Patricia A. Weitsman

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List of Acronyms

ASBJ	Accounting Standards Board of Japan
AcSB	Accounting Standards Board (Canada)
AOSSG	Asian-Oceanian Standard-Setters Group
ASAF	Accounting Standards Advisory Board
ASSC	Accounting Standards Steering Committee
BAC	Business Accounting Council (Japan)
CICPA	Chinese Institute of Certified Public Accountants
CPC	Brazilian Accounting Pronouncements Committee
ECSDA	European Central Securities Depositories Association
EFRAG	European Financial Reporting Advisory Group
ESMA	European Securities and Markets Authority
FASB	Financial Accounting Standards Board (U.S.)
FPSB	Financial Planning Standards Board
FSB	Financial Stability Board
FRRP	Financial Reporting Review Panel
FVA	Fair Value Accounting
GAAP	Generally Accepted Accounting Principles
GLASS	Group of Latin American Accounting Standard Setters
HAASOB	Hellenic Accounting and Auditing Standards Oversight Board
HCMC	Hellenic Capital Market Commission
HFSB	Hedge Fund Standards Board
HFSF	Hellenic Financial Stability Fund
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
ICAEW	Institute of Chartered Accountants in England and Whales
IEC	International Electrotechnical Commission
IFAC	International Federation of Accountants
IFRIC	IFRS Interpretation Committee
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions
ISO	International Standards Organization
KASB	Korean Accounting Standards Board
PAFA	Pan African Federation of Accountants
SEC	Securities Exchange Commission
SME	Small and Medium Sized Entities

Chapter 1

Regulating International Capital: The State and Private Rulemakers

"*The changes [we made] were not very big, but the banking industry was in such bad shape that every improvement, no matter how small or cosmetic, was considered to be helpful. It was a classic example of bending the rules to make things look better because the reality was too ugly to be faced up to.*"

-Hans Hoogervorst, President of the International Accounting Standards Board, 2013

Built through global cooperation, International accounting standards are the foundation that supports cross-border investment. In the 1990s, countries and multinational firms began to converge on US accounting standards, yet EU standards became dominant by 2010. In this global transition, political decisions pushed aside technical concerns as states decided their level of cooperation, which often included large rule carve-outs, with the EU standard setting body: The International Accounting Standards Board (IASB).

As political scientists and accounting professionals moved to understand the global change in standards, their research treated cooperation on accounting as uniform and implicitly Pareto efficient. This may be because financial standards traditionally have been set by private bodies and viewed simply as technical standards with broad global support, [1] yet this view is wrong. Analyzing the global spread of standards can only be done through a lens that acknowledges the inherent problems plaguing global convergence. For example, failure to

[1] Statements of support from the G20: http://www.g20.utoronto.ca/2013/2013-0720-finance.html, World Bank & IMF: http://www.imf.org/external/np/exr/facts/sc.htm, FSB: http://www.financialstabilityboard.org/2014/09/pr_140918/.

recognize partial cooperation and other standards issues led Simmons (2001) to incorrectly predict the dominance of US standards. If she and other scholars had recognized that cooperation is often partial or incomplete, they could have more easily seen a global shift from US to EU standards.

While international accounting standards create transparency in cross border investment, they are still not ubiquitous and suffer from partial cooperation. Efforts to make them global and uniform internationally have a long history with international financial standard's first appearance in 1494 in Pacioli's *Summa de Arithemetica, Geometrica, Proportioni et* Proportionalita, and again in Napoleon's France alongside the rise of the metric system. In fact, people have always thought that accounting standards were purely technical, and would become homogenous in much of the same way as the metric system. However, standards are heavily politicized and this is the reason international cooperation failed despite support from organizations like the G20 and the World Bank.

This politicization is due to how standards impact countries' economies and firms. Accounting standards define the complete financial health of firms and industries by dictating how they must treat profits, losses, debts, and assets. While this seems simple and technical, there are no methods of determining firm financial health that are universally agreed upon. A firm in India with the exact income, assets, and liabilities as a firm in the US may have extremely different profits and losses. A small change can be very powerful and internationally changes can be difficult to reconcile between countries. For example, the US government changed a rule for AT&T in 2016 that added billions in value overnight (with the same income, assets, liabilities, etc.). Similarly, after the reclassification of a debt rule in the EU in 2008, Deutsche

Bank avoided a €845 million write-down. With this change, the bank's forecasted losses turned into a €414 million profit (Camfferman & Zeff 2015). Thus, differences in these standards affect central elements of the international economy.

To complicate international cooperation, each country may have a set of actors (e.g. standard setting bodies, governments, or firms) that believes their methods or approach to financial standards are best. These actors include governments, private regulators, investors, large firms such as banks, and professional accountancy organizations. Furthermore, these actors across countries tend to have different views on international standards as Buthe and Mattli (2008) demonstrate. Often competition between these groups and their changing makeup work together to create differences in how countries apply international accounting agreements. Thus, domestic actors should part of the analysis regarding the breakdown of these types of international agreements.

For governments, they represent both firms and investors, so policy will likely represent a compromise between firms' interests in more flexible accounting and investors' interests in fair representation. For investors, fair representation means that the policies enacted promote firm practices which ensure that financial statements reflect the current market value of assets and liabilities. For private regulators, in most countries, they help formulate policies in conjunction with governments and are somewhat accountable to the interest of firms and investors.

At the international level, the policies of capital exporting countries will lean in favor of fair representation (accuracy) while the policies of capital importing countries may allow some misrepresentation that will encourage investment. Capital exporting countries will be reluctant

to change their standards since there is no need to attract additional capital. Because of the desire for investment in capital importing countries, cooperation and coordination at an international level is difficult.

Despite these biases, there will be some shared interests in greater accuracy and better information provision. In addition, firms with cross-national interests will have an interest in standardizing rules across countries in order to simplify their own accounting (Mckeen-Edwards & Porter 2013). National governments will share these common interests to overcome the political hurdles to these seemly technical standards.

These incentives create a politically complex setting for financial governance. In simple terms, countries have an incentive to "cooperate," pursuing common goals in a situation that resembles the well-known Prisoners' Dilemma (PD) problem. As in PD, they may have an incentive to "cheat," attracting some extra investment at the margin by loosening accounting standards a bit. This incentive to cheat may be exacerbated when capital is scarce during economic downturns and financial crises.

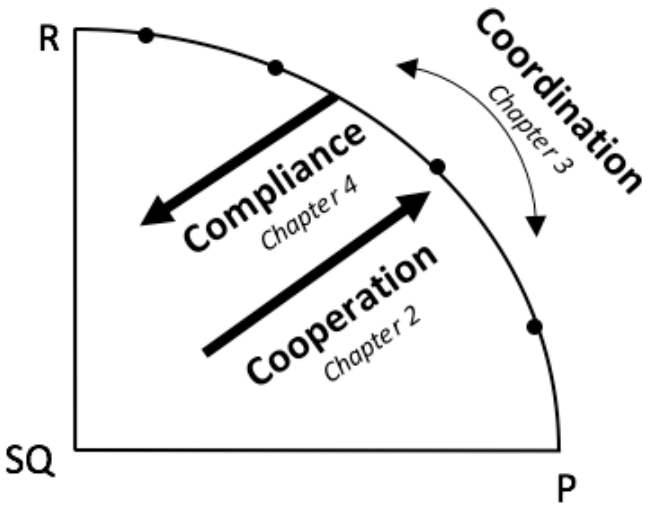
Accounting standards also face a logically-independent coordination problem. Multinational firms and the governments that represent them benefit from *common* standards across boundaries, independent of any desire to attract investment (Krasner 1991). Yet they will disagree about *which* economic sectors or firms should use them. Many of these decisions are technical choices on which accountants will disagree. At a simple level, each firm will want the world to coordinate on the standards found in its home country, standards that its current staff already know and can work with.

Finally, international accounting standards must overcome a regulatory compliance problem that is also found in other financial agreements. First, many countries use private bodies to interpret new financial rules and these regulators often have incentives to misinterpret international standards. These incentives stem from a lack of political and financial independence. Second, firms may fail to comply because of a lack of official enforcement from government bodies.

To explain differences in international financial standards, I develop three lenses or models in the subsequent chapters that envelop the main political challenges to international standards. First, the cooperation[2] model discusses how a single standard moves countries to an optimal point, and countries' concerns and motivations for using a single standard (figure 1.1). Second, the coordination model discusses who uses the standards within countries due to international agreements. Broadly, how they are applied to different firms and how this moves countries to different points along the Pareto frontier. Finally, the compliance lens discusses how regulators have perverse incentives to ignore international agreements and how this moves countries away from the Pareto frontier to a suboptimal point. Throughout these chapters and more so in the conclusion, I discuss how anticipated compliance in the third lens influences early cooperation and coordination decisions.

[2] Throughout this project, I speak of international accounting agreements in the context of cooperation. I recognize that accounting cooperation can take different paths such as convergence versus adoption and that there is not always a formal written agreement in all cases. However, I feel examining the political side of this does not require me to make the small distinctions in each case and throughout the project. A future iteration of this may consider these cooperation differences.

Figure 1.1: Cooperation, Coordination, and Compliance on the Pareto Frontier



The Decline of US GAAP and the Rise of EU IFRS

The initial efforts to create a universal standard to measure financial health (i.e. international accounting standards) grew from the cooperation among private groups in the US, Canada, and the UK in 1966. During this time, US standards slowly gained support as International Financial Reporting Standards (IFRS) in the EU were still in their infancy. The US's eventual loss to the EU despite its overwhelming market power was a result of the politicization of technical standards, and the way in which countries began to cooperate piecemeal on standards with the IASB (EU Regulator). This politicization and widespread partial cooperation (i.e. use of large rule carve-outs) worked together to thwart US dominance. My approach in this project helps understand these unique shifts and why governments and private bodies backslide in these international agreements and abandon certain rules.

Accounting standards became more of a political issue than a technical issue in the US and UK in the early 1970s. In this era, governments began to legislate rules to make their domestic firms' financial health appear better, at times as a way to help their firms compete with foreign competitors. This prevented some of the initial harmonization between the US and UK, and later, as I argue, hindered cooperation between countries by creating suboptimal international rules.

The failure of international cooperation and coordination started with small legislative acts to prevent international agreements between private regulators. In 1974, with inflation rising and new competitors moving into domestic banking markets, the UK Parliament blocked its accountancy board, the Accounting Standards Steering Committee (ASSC), from moving toward US rules.[3] The argument against US rules was it would make UK corporations seem like unattractive investments while increasing some tax obligations and hindering their competitiveness. These early concerns over capital flows and foreign direct investment were during a period of simpler financial rules and less globalization. The political battle over standards has since increased.

While Britain struggled with US rules, in the 1970s the US began manipulating accounting rules to change the financial narrative of sectors and make industries appear more competitive. To allow US firms to report fewer costs for exploring for oil, the U.S. Congress and the Securities and Exchange Commission (SEC) drafted legislation modifying accounting rules

[3] Specifically, (SSAP) NO. 11 concerning differed taxation. I have simplified the explanation here for the sake of readers unfamiliar with accounting.

for larger oil firms (Zeff 2010)[4]. This benefited domestic oil firms at the expense of foreign companies. During normal economic times states may not feel pressure to make changes like this, but economic crises cause states to manipulate accounting rules to make their financial health seem better. This occurred frequently after the 2008 financial crisis, and, as I argue later, is another reason why international cooperation fails with these types of international standards.

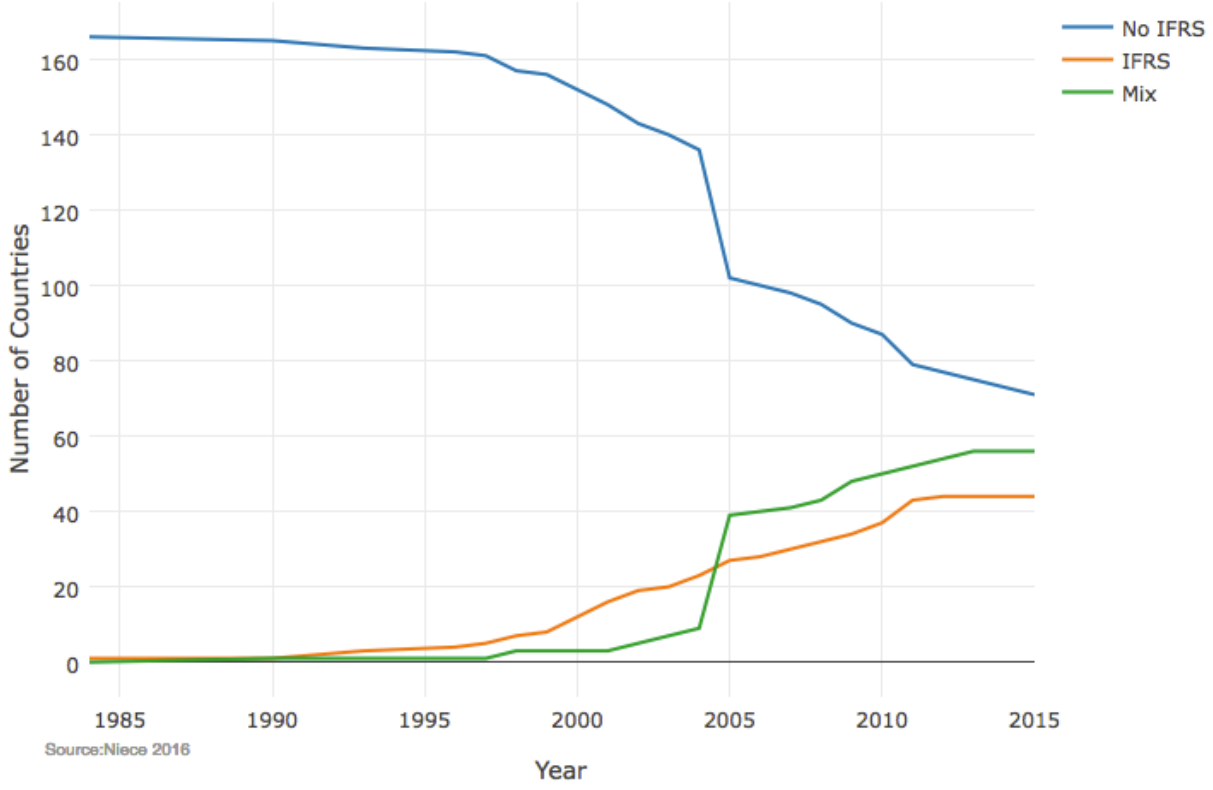
At the same time the standards began to become politicized in the US and UK, the American Institute of Certified Public Accountants (AICPA) established worldwide branches of the International Accounting Standards Committee (IASC) to broaden cooperation.[5] IASC included Australia, Canada, France, Germany, Japan, Mexico, Netherlands, the UK, Ireland, and the US. This organization, though founded with a strong effort from the AICPA (US), would later become the International Accounting Standards Board (IASB) (EU regulator) in 2001. However, despite its growth and development of IFRS, many member states such as Japan, Mexico (until 2007), and the US maintained their own standards. Other founding members would eventually use IFRS with large rule carve-outs (UK, Ireland, France, Germany, and Netherlands).

[4] At the time, US oil firms could use any type of accounting they wanted so it is a safe assumption they pushed back against FASB regulations because they revealed more costs. Ketz (2006) Accounting Ethics book touches on this very slightly.

[5] At this point in history, it was largely a private effort to broaden cooperation with little backing from governments.

[6] This data, like all data in the charts is from the IASB. The documents listed on the IASB's website update yearly and normally include a first year that a country used IFRS. An archive of the 2014 version of these documents can be found at my personal website. For the purposes of this chart, I have listed the years as when countries first implement IFRS instead of when the first law or agreement was made indicating future IFRS use. I did this because sometimes the delays between law and actual first use can be substantial.

Figure 1.2: Countries Using IFRS[4]



After the formation of the IASB, growth in countries committing to IFRS with the IASB grew massively (figure 1.2). This growth can be attributed to two factors. First, as the IASB formed, several countries around the world lost faith in US standards due to the Enron and WorldCom accounting scandals.[7] New Zealand and Australia as well as other countries cited[8] these events as reasons to move to IFRS from US GAAP. Secondly, countries' standards boards that cooperated with the IASB found new ways to adopt international rules. Instead of using all of a particular standard for a country's entire economy, countries slowly started adopting IFRS

[7] Worldcom was less of a failure by the FASB. However, the FASB allowing Enron to use mark to market accounting could be interpreted as a failure of the standards board.
[8] These were in official government reports.

rules partially and for only some economic sectors. Furthermore, most countries started using an endorsement body[9] to regulate compliance and approve new rules.

Outside of scandals and the piecemeal adoption of IFRS, there were practical reasons to move to an international standard. Among these practical reasons was the US government's lack of support (or effort) in developing US GAAP as a truly global standard. US trade officials formalized some accounting standards into NAFTA but otherwise were unsupportive of their private regulator's global efforts in working with other countries. This may have been due to the erroneous belief that US market power alone would allow US standards to dominate without flexibility and strong international efforts.

Secondly, accounting differences across borders were creating vast differences in firm valuations. This had the potential to disrupt cross border investment given the lack of transparency and comparability between firms internationally. Only cooperation on a single global standard could solve this problem, and the independent[10] IASB could provide a platform for international dialogue and cooperation.

Accounting disparities were large enough by 1993 that the Daimler-Benz Corp reported a $1.1 billion loss under U.S. accounting rules but a $373 million profit by German accounting rules (Radebaugh et al. 1995). Thus, the movement to a single standard would aid global capital flows by creating uniform understandings of firm financial health (e.g. income statements,

[9] I explain all of this in the appropriate chapters. Here my intent is to give the reader an idea where I am ultimately going on without getting into unnecessary details.
[10] Since 2009, the IASB could not be characterized as independent from the EU. However, in its early days, it did appear and act as an independent body.

balance sheets, etc.). However, as I demonstrate in this project, a single international standard has yet to become a reality.

The main problem with accounting differences in the 1990s and presently is that they obscure financial health, affect foreign direct investment (FDI) and trade, and to a lesser extent GDP calculation (Beneish 2012; Chen et al. 2014; Marquez-Ramos 2011; Zaidi & Huerta 2014). Additionally, accounting standards have the potential to create value where it may not exist by altering income, assets, and liabilities. As international capital flows and multinational firms increased, there has been an international demand for a uniform set of rules.

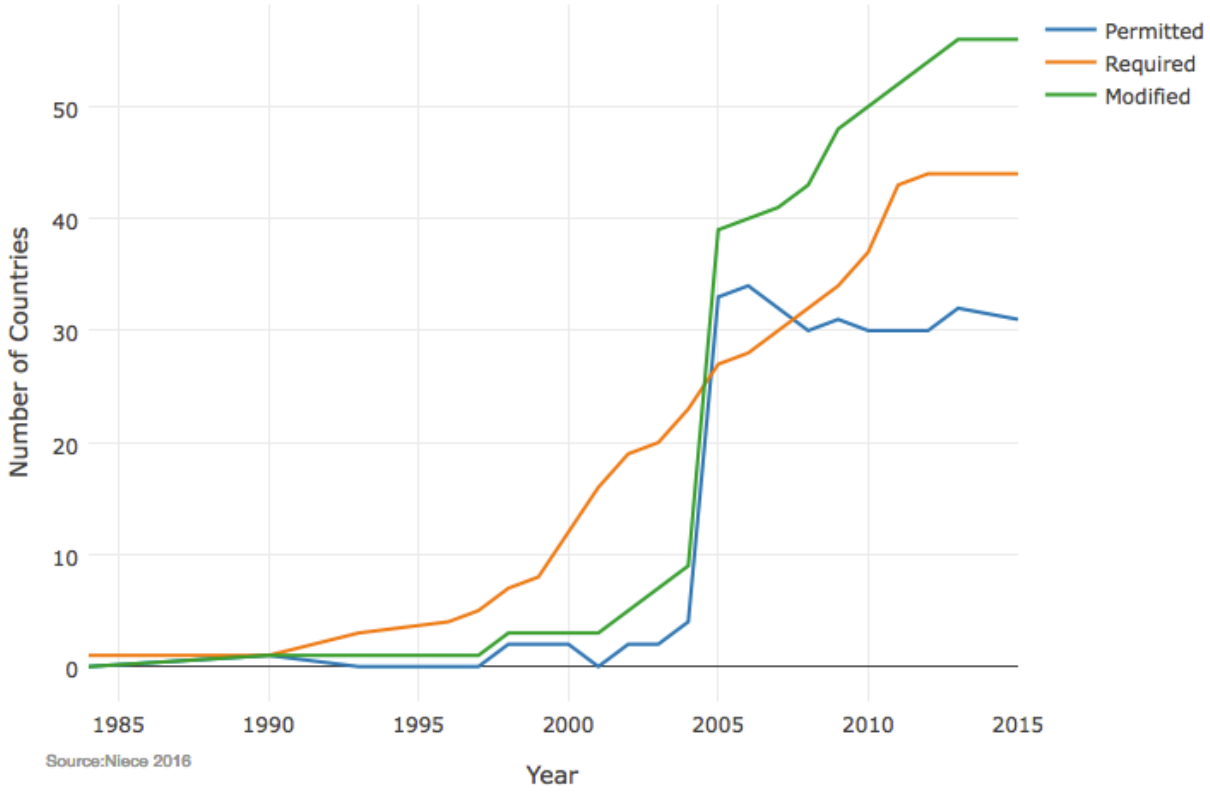
After the Formation of the IASB

To address these large accounting differences and promote cooperation, the IASB (EU regulator) created a committee of 14 members to vote on international rules (later increased to 16 members). The purpose of this committee was to move from the rigidity of US standards and give a small voice in rulemaking to other regions. Within this committee, all votes are treated equally with majority rule.

Despite intentions to represent diverse nations, the IASB's voting structure has hindered the development of truly global standards. With 9 votes needed to change rules and the EU members outnumbering others, regions that only had one vote such as South America have been less likely to get their issues addressed. Still the number of countries using only IFRS without any rule carve-outs or partial cooperation (i.e. a separate domestic version of standards) has continued to grow. Nevertheless, there has been substantial changes or fragmentation of international standards in many of these IFRS only countries.

This fragmentation is a result of countries partially cooperating with the IASB which has been an increasing trend since the late 1990s. As seen in Figure 1.3,[11] many countries have signed agreements to use IFRS, but, instead of following IASB rules, have implemented their own versions of IFRS with rule carve-outs (displayed below as Modified). Countries that do not require IFRS or

Figure 1.3: IFRS Use On Global Stock Exchanges



modified them in Figure 1.3, at a minimum, allow at least some firms to use IFRS while typically requiring them to prepare an additional set of financial statements using the country's non IFRS

[11] Data from IASB's country reports (2014 version). Modified and permitted are easily identifiable in these documents along with the modifications implemented (usually known as rule carve-outs). Required, in this graph, means exactly as dictated by the IASB. Permitted means some firms may legally use them.

standards (displayed below as Permitted). In addition to partial cooperation via Modified or Permitted standards, compliance remains a challenge. Non-compliance is another form of partial cooperation.

Many countries not using IFRS made formal commitments with the IASB or other bodies but have since reneged on their agreements. For example, in 2007 Japan signed the Tokyo Agreement with IASB officials but has moved away from this commitment. Similarly, the US regulator has held joint meetings with IASB since 2001 with the intent of using IFRS but no meaningful progress has occurred. In the US's case, the former US Securities and Exchange (SEC) Commission Chair, Chris Cox, posited the US has not been able to discern if the IASB has the US's best interests in mind. Historically, countries' interest, or their political stake in international accounting standards, has included broad macroeconomic and firm specific concerns (discussed in Chapters 2, 3, & 4).

Recently, some of the political concerns of nations using international standards have been addressed in major reports by the big four global accounting firms. For example, a 2014 report by Ernst and Young stated that:

> [rule approval regarding IFRS in the EU] is now coming from the European Financial Reporting Advisory Group (EFRAG) (rather than technical experts). This means national interests will probably be expressed more strongly, and there is a risk of politics playing a bigger role in the [rule approval] process.…If the EU rewrites IFRS to meet its own preferences it would destroy the aim of achieving a single set of global accounting standards.

The report stated that international cooperation may collapse given the broad carve-outs (i.e. partial international cooperation) by countries.

Throughout history and more frequently in the last forty years, differences in accounting standards developed to serve political ends. Control over a country's financial reporting standard may be advantageous for leaders who wish to show better economic health or attract foreign investment. Additionally, financial crises can be dampened if banks can report their assets and liabilities differently. Financial reporting standards also determine tax liability and are necessary for fighting corruption.[12] Changing accounting standards can help governments procure loans from governments or creditors such as the World Bank in addition to improving multilateral foreign aid flows (Baskerville 2013; Efobi & Nnadi 2015; Hegarty et al. 2004; Lamoreaux et al. 2014).[13]

Furthermore, most international cooperation on standards takes place between private bodies and other private bodies. For example, the IASB may cooperate with the private US standard setter. Some countries do not use private standard setters and instead use government ones (e.g. Russia, China, others). Thus, some international cooperation is between the IASB and a foreign government body. Rarely, and usually only through trade agreements, does cooperation on accounting standards occur directly between two governments.

Standard setting boards like the FASB or IASB may be mostly private bodies and mostly distinct from government entities, but they are guided by government policy, subject to legislation, and often are not financially or politically independent. Thus, this project in each

[12] Snidal & Abbott (2001) also note enforcement is necessary as well. See Walter (2008) for the nuances of compliance within the scope of the FSB.
[13] A brief look at the IMF & IFRS: www.imf.org/external/pubs/ft/finop/2014/pdf/ch6.pdf

chapter attempts to give attention to states as much as private actors for determining international regulatory outcomes. However, as I discuss in Chapter 2, the best international cooperation is possible when states leave international regulation in the hands of private groups.

In this section, I have emphasized the partial cooperation problems for international financial standards are not new phenomena (See Zeff 2008 for a complete political history). Additionally, I have briefly outlined the transition from US standards to EU standards (IFRS) and how countries began to use IFRS piecemeal and partially. Over time, these seemly technical standards have become a political tool to change the economic narrative for governments when convenient. Without the intervention of government interest, accountants and technical experts would have a better chance to achieve full cooperation and harmony in international accounting standards.

The Diffusion of International Standards

The partial carve-outs and piecemeal adoption of IFRS are examples of asymmetric international cooperation. In the standard S-curve that is common in studies of diffusion, (Berry & Berry 2007; Rogers 2003; Simmons & Elkins 2004) at the end of the process most countries are using the same standards or rules. With US GAAP presently (though greater prior to IFRS) and with IFRS, the diffusion of these standards has been partial and characterized by backsliding. Every accounting standard faces its own partial cooperation and coordination problems that produce this result. The current literature on policy diffusion (e.g. Dobbin et al.

2007; Simmons et al. 2006; Weyland 2007) would predict the wrong outcome for global accounting standards by ignoring the heterogeneity of international cooperation.

The trend in political science research and elsewhere has been to theorize about which regulatory standard would diffuse the fastest internationally: US GAAP or IFRS (Eaton 2005; Eberle & Lutz 2008; Posner 2009 & 2010; Simmons 2001; Veron 2007). The iterature has also treated each IFRS adoption and US GAAP adoption as the same. This myopic approach may be the result of political scientists misunderstanding the importance of rule-carve outs (i.e. partial cooperation). Alternatively, this piecemeal adoption may be ignored since political scientists may believe country influence (via markets mainly) will lead to a complete adoption of a single standard eventually. However, in this project, a close examination of adoption patterns reveals that partial cooperation, coordination, and noncompliance persist.

The failure of scholars to understand the nuances behind the spread of accounting standards has led to some incorrect predictions. For example, Simmons (2001) posited IFRS would decline the early 2000s and US GAAP would become dominate again (Figures 1.2 shows the opposite). The logic in this prediction was simply US market power would cause other countries to follow along. Similarly, Posner (2010) posited the US would soon adopt IFRS, and IFRS's spread was due to a sequence of unique political events in the US and EU. These predictions conform to the standard notions of policy diffusion, yet the fail to explain the puzzle of partial diffusion (i.e. partial cooperation, coordination, and noncompliance).

Drezner (2008) stated the spread of regulatory outcomes, such as IFRS, are a function of great power politics. Globalization, according to Drezner, aids states in coordinating policies but only when the policies are beneficial to major powers. However, as I demonstrate in this

project, coordination and cooperation are often partial throughout countries both large and small for accounting standards. Drezner's theory may apply to other domains, but it explains very little behind the unique spread of IFRS.

Other research has theorized IFRS spread as a function of country ties and political power (Lamoreaux et al. 2014); Ramanna & Sletten 2009 & 2013). Ramanna & Sletten (2009) claimed more powerful countries, operationalized by how often they serve on the UN security council, would be less likely to adopt IFRS. Following this study, Ramanna (2013) posited a potential voting seat in the IASB and close political ties to the EU would make countries more likely to agree to IFRS. These studies fail to explain the existence and spread of multiple accounting standards (i.e. second sets of accounting standards through partial cooperation or pieces of US GAAP mixed with IFRS in some countries).

Buthe & Mattli (2012) analyzed the private aspect of international rulemaking in IFRS, but their analysis and theory primarily focused on domestic aspects of EU and US rulemaking. In particular, they developed a theory explaining why US regulators are more responsive to firms' needs than their EU counterparts. While this is useful first step to understanding the role private regulators have in international regulatory outcomes, it did not address the spread of multiple standards in these countries.

Similarly, other political studies illustrate the impact IFRS has on states' behavior (Gordon et. al 2012; Lamoreaux et al. 2014; Mckeen-Edwards & Porter 2013; Perry & Nolke 2006; Porter 2005). For example, Lamoreaux et al. (2014) demonstrate countries sometimes adopt IFRS to appear more transparent to official creditors such as the World Bank or IMF, and Gordon et. al (2012) emphasize countries may adopt IFRS to increase their foreign aid.

Moreover, Perry & Nolke (2006) posit IFRS adoption shifts power away from the productive sector of the economy. These studies are testaments to the power of private regulators and bodies like the IASB, but they must be complemented by research that answers why IFRS has spread in its unique way.

To address the trends of partial cooperation and inconsistent patterns of diffusion, this dissertation develops three separate lenses or models of the adoption and use of international accounting standards. These three models each discuss a different problem in the process of countries formally committing to IFRS and similar financial agreements, and why countries may deviate from the international community (See table 1.1). Together these lenses or models give a complete picture of why these international regulatory outcomes have been fragmented and poorly explained by prior research. Besides IFRS, I also discuss other regulatory areas where each lens aids the understanding of international outcomes.

Table 1.1[14]: Cooperation, Coordination, and Compliance within the G20

Country	Partial Cooperation	Partial Coordination	Potential for Noncompliance
Argentina	No	No	Yes
Australia	Yes	Yes	Yes
Brazil	Yes	Yes	Yes
Canada	No	Yes	No
China	Yes	Yes	Yes
European Union	Yes	Yes	Yes
France	Yes	Yes	Yes

[14] Data from Deloitte and represents the G20 in 2015 using partial cooperation, coordination, and noncompliance definitions present in this chapter and the following. Potential for noncompliance means the country has an endorsement body that can alter compliance. This is discussed more in chapter 4. The US is a little different in this chart than how it is presented in chapter 4 because it has not "officially" adopted IFRS yet.

Table 1.1 (cont.)

Country	Partial Cooperation	Partial Coordination	Potential for Noncompliance
Germany	Yes	Yes	Yes
India	Yes	No	Yes
Indonesia	No	No	No
Italy	Yes	Yes	Yes
Japan	Yes	No	Yes
Korea (South)	No	Yes	No
Mexico	No	No	No
Russia	No	Yes	Yes
Saudi Arabia	No	No	No
South Africa	No	Yes	No
Turkey	Yes	Yes	No
United Kingdom	Yes	Yes	Yes
United States	No	No	No

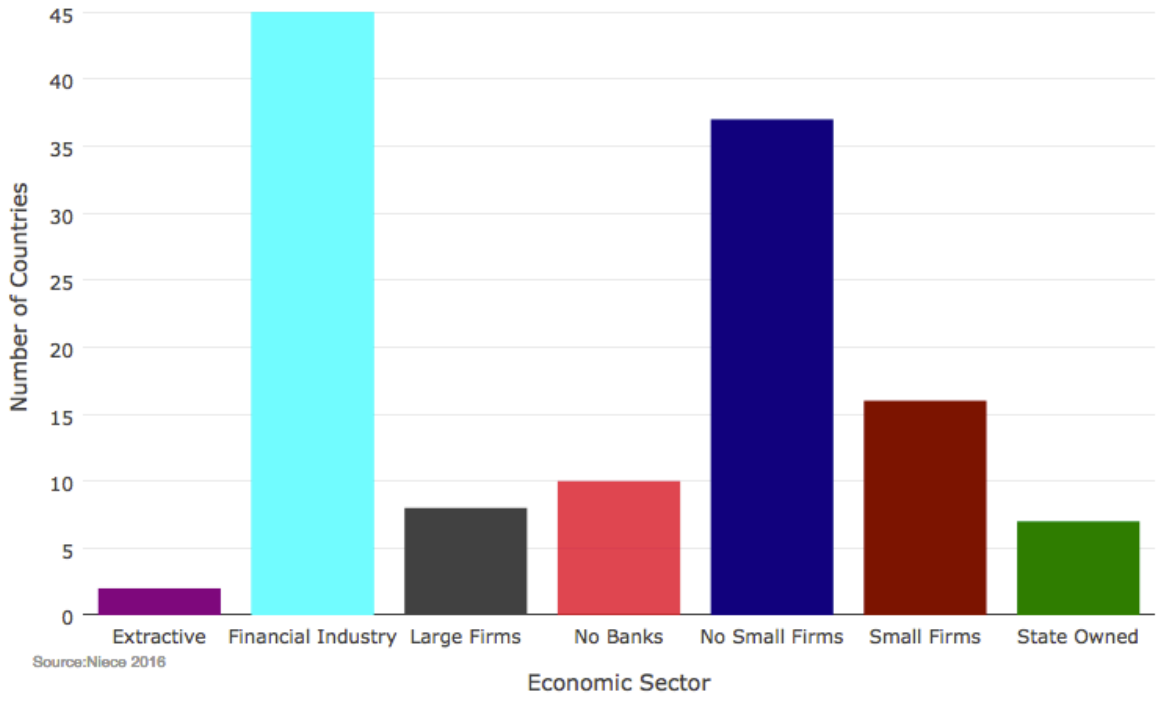
The cooperation chapter explores why countries agree to use the same Pareto optimal standard and why partial cooperation is a product a prisoners' dilemma type environment. For political challenges, this chapter illustrates how macroeconomic concerns (FDI & trade) cause countries to renege on agreements and modify IFRS as seen in Figure 1.3. Modifications are often a complete departure from the rules of the IASB and make it difficult to compare firms across countries. The incentives to deviate are strong, as I show in chapter two, with FDI and trade gains nearly double for countries using modified IFRS than the standard increases in countries not cheating. Nevertheless, private regulators have incentives to keep their countries using unmodified standards and sometimes are able to block governments from intervening. The primary lessons from this model are net capital exporters want full cooperation, net capital importers would rather partially cooperate, and the overall pattern of cooperation is similar to what is seen in the trade literature.

Broadly, this model explains how countries cooperate to get to the Pareto frontier in the context of international financial standards while the issue of which point along the Pareto frontier is addressed in the following model (coordination). The cooperation model gives insight into the variation in Figure 1.2 and how countries mutually benefit even if one uses a modified version of IFRS while another uses its pure form. Furthermore, while accountancy boards push for unmodified IFRS, this chapter demonstrates the economic and political costs often push countries in different directions that are still beneficial.

The coordination chapter approaches coordination from a Krasner standpoint and illustrates how different policies on the Pareto frontier, such as who must use the standard within the country, are chosen in the context of international financial standards. For example, why do countries agree to a standard like IFRS but exclude specific sectors or rules (Figure 1.4[15] shows some instances of this and Figure 1.1 has modified rules that are also an example). Often, exclusions are driven by the perceived costs of firms converting weighed against the benefits of IFRS. These benefits may be ease of business with international partners or subsidiaries abroad and ease of entry into international markets. There is also an issue of how well the regulators understand the impact of international rules on sectors. Unlike the cooperation model, investment and trade do not enter into the decision-making process of private regulators or the state.

[15] This data is from the IASB's 2014 country reports. For countries excluded from that report, the most recent data from 2015 from the IASB plus organization was used. Each column represents an agreement between the IASB and government (or private regulator when appropriate) when the agreement specifically singled out the inclusion of that sector with the exception of the "no banks" column. The "no banks" represents the agreements that specifically exclude financial firms such as banks (though usually insurance is included, too).

Figure 1.4: International Coordination and Country Sectors used in Agreements

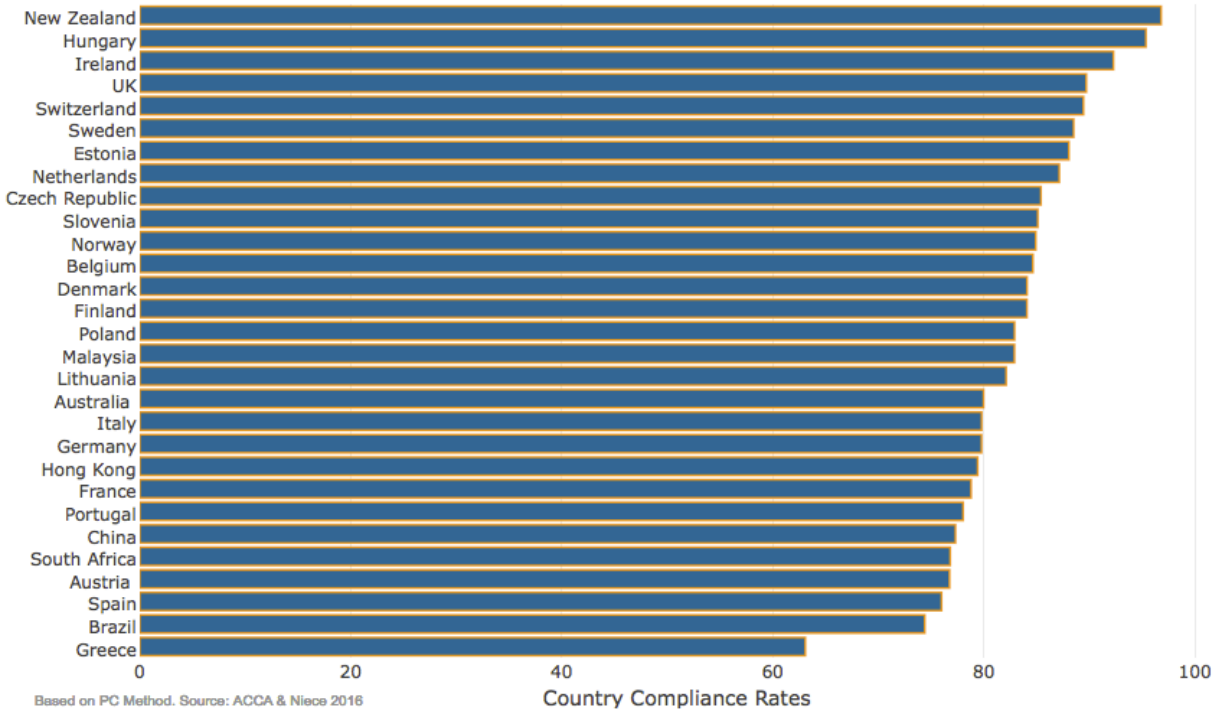


After reaching the Pareto frontier and a specific point along the frontier in an agreement, a country's actual compliance with IFRS (Figure 1.5[16]), or another regulatory standard, may make the agreement suboptimal. This third model of compliance (chapter 4) has

[16] The data here display the aggregate compliance rate of all country firms. This is more of a proxy figure, though the best and only measurement, of how well on the aggregate standards boards adhere to IFRS (the interpretation of rules, their delay, etc.). Figure 1.5's data comes from a report 136 by the ACCA with data from a few countries from Amirasalani et al (2013) which is only slightly outdated. The PC method or partial compliance method asks if a firm violated a standard and gives equal weight to all standards. This is in contrast to the dichotomous method that looks at the individual items for each standard and gives them equal weight and asks which percentage was violated. Since rates are typically given for different sectors, the data here is the average of all economic sectors (which does not have a lot of variation).

two problems endemic to international financial agreements. First, in the initially process of adopting IFRS, many countries opt to have their private or government standards agencies to act as endorsers that must sign off on any changes the IASB makes before they become rules within their borders. Currently, 59% of IFRS agreements include an endorsement clause so any changes made to IFRS can be reviewed, possibly changed, or delayed. Thus, compliance with the agreement may be hindered through the endorsement process.

Figure 1.5: International Compliance Rates in 2014



The second issue with compliance is private regulators have perverse incentives to not enforce international agreements. This builds on the other two chapters by demonstrating why international capital regulation based on private regulators is nearly impossible. For example, studies have shown compliance with IFRS can be less than 50 percent and I posit this is a result of private regulators' commercial interests and political pressures. Specifically, when private

regulators must raise funds or rely on donations to operate (e.g. the EU), commercial ties influence how strictly they enforce international regulations. Additionally, this chapter highlights the importance of the political independence of regulators, and examines how governments may pressure regulators to overlook noncompliance to renege on a regulatory agreement.

Table 1.2: Overview of Models

Model	Scope	Issues Driving Actor Behavior
Cooperation	Carve-outs from the Standard	Defection for Trade & FDI
Coordination	Which Sectors/firms use the Standard	Firm Costs & Regulator Expertise
Compliance	Interpretation and Implementation	Endorsement & Agency Independence

At the end of each chapter, though more thoroughly in the conclusion chapter, I discuss how the lenses or models relate to each other. Briefly here, I posit that anticipated compliance drives the initial level of cooperation and coordination. This is due to determinations about cooperation and coordination occurring closer to the start of an agreement whereas noncompliance tends to occur later (if possible). The caveat, however, is not all countries have the capacity for noncompliance. Noncompliance is dependent on a national endorsement body (a board that interprets, delays, or rejects new rules) and only if that national endorsement body is under political control (explained more in chapter 4). Countries without endorsement bodies tend to accept new IFRS rules completely and immediately.

For countries with politically controlled endorsement bodies, cooperation and coordination carve-outs tend to be less severe. This is because the agreements can be modified

later in the short-run. Furthermore, noncompliance is usually not a long-run strategy with accounting standards, so countries are more likely to lock in their larger disagreements with IFRS using partial cooperation and coordination.

Broader Applicability

These problems are not specific to financial reporting, but are generalizable to other areas of international cooperation that involve a mix of public and private regulators or for implementing new standards that are discontinuous and distinct from domestic policy. For example, the International Organization of Securities Commissions (IOSCO) and the Financial Stability Board (FSB) also suggest similar financial rules for their member states. Likewise, some Basel II requirements can be met by adopting parts of IFRS. In fact, there are overlaps between IFRS and the Basel Accords that I explore in chapter 4.

This project primarily focuses on international accounting because unlike other international standards (e.g. metric system and ISO standards), they are often agreed upon in full and then adopted in pieces or heavily modified (See Figures 1.1, 1.2, 1.4, & 1.5). Additionally, private regulation in the global economy, which IFRS is a prime example, is likely to be increasingly common while affecting FDI, trade, and GDP, and its problems in the areas of international cooperation and coordination are understudied. The lenses in this dissertation are necessary to understand the variation in cooperation on international standards and why complete adherence to these types of agreements may never become a reality.

Ultimately, the applicability of these lenses or models to other issues areas depends on the actors and the costs associated with international regulatory changes. For example,

international standards concerning methods of disclosure from the Hedge Fund Standards Board (HFSB) are arguably only technical concerns. Since there are no economic costs with such regulation, it is unlikely my cooperation model with its macroeconomic focus would apply, but the coordination model would be applicable since there is technical convergence between firms. How other regulatory outcomes are similar to IFRS is expanded upon in the following chapters.

Why Are Standards Incompatible and Partial?

One of the biggest issues for countries agreeing to IFRS is differences between standards are often discontinuous and incompatible. For example, there are over 400 differences between US GAAP and IFRS, and many of these lack a middle ground. In this section, I review a small selection of these incompatibilities to give the reader an idea of why the diffusion of standards is so complicated. Out of the 400 or so technical differences, I arbitrarily discuss only three that the EU and US claim they cannot compromise on. For readers familiar with accounting, this section can be skipped.

First, the sale of goods between IFRS and US GAAP can be quite different. Under US rules (and those of other countries) revenue from sales is not recognized until the delivery of goods has taken place, and the collectability of the fees (i.e. money from sales) is assured. On the other hand, IFRS rules allow, under some circumstances, for revenue to be recognized prior to delivery and under the assumption that it is probable the economic benefits will flow to the company.

Secondly, the way inventory is measured is fundamentally different between US GAAP and IFRS, and can cause firms to report vastly different profits. For example, the use of last in first out (LIFO) as an inventory system can be used in the US (banned under IFRS), and first in first out (FIFO) is used under IFRS. The difference in these systems is when a sale happens, the cost of that sale is either determined by (1) the cost of the last good bought (i.e. LIFO) or (2) the cost of the good when it was acquired (i.e. FIFO). While outside the scope of this paper,[17] one can imagine as the cost of goods acquired (to later be sold) changes, the recorded profits and tax implications can vary substantially.

Third, another example of incompatibilities between standards is how long-lived asserts (e.g. property, plant and equipment) are valued. First, US GAAP does not permit revaluation of these assets nor depreciation of assets individual components, yet IFRS allows both of these actions. Second, under US GAAP borrowing costs for these assets do not include exchange rate differences while they must include these differences under IFRS. There are even greater differences beyond this for long-lived assets, but I believe exploring these is unnecessary for the scope of this project.

These incompatibilities are an incredibly small fraction of the overall differences in accounting standards from country to country. In some areas, like long-lived assets, there may be a possibility for compromise (however the US and the EU have stated they cannot even converge these[18]). In other areas, such as inventory costs, it is impossible to adjudicate the

[17] Investopedia and several other online resources are filled with examples of how this affects firm valuation and cross border firm valuation. I would love to go into more detail here, but my focus in this paper is mainly politics, not accounting. I merely give these examples to give the reader an idea of the possible incompatibilities in standards.
[18] 2009 US GAAP vs. IFRS report by Ernst & Young.

differences between LIFO and FIFO. These kinds of differences ultimately lead to countries adopting parts of accounting standards piecemeal (partial cooperation) or for only some sectors of the economy (partial coordination).

Incompatibilities and Selective Sector Use

Outside of the scope of rules, coordination issues mean regulators or government bodies must decide who the rules will impact within an economy. Countries may choose to apply IFRS to publically listed companies (those listed on a stock exchange) and unlisted companies (private companies) that may be audited by the home government, or only use IFRS for firms in one of those categories.

Using IFRS for public companies has several benefits already listed such as increased FDI, increased trade, and better auditing leading to less tax evasion. Private companies (unlisted) using IFRS may not increase FDI or trade because their statements will not be open to the public, but using IFRS allows them to increase investors and list themselves on stock exchanges in the future. Table 1.3, which is a detailed version of the data from table 1.1, shows a sample of countries and how they apply IFRS to their publically listed companies and their private companies. If a country does not permit IFRS for a group, it means IFRS use is against the law for that set of firms or sector.

Table 1.3: A Selected Sample of IFRS Cooperation and Coordination[19]

Country	Public Firms	Private Firms
Argentina	IFRS required for some	IFRS not permitted
Australia	Local IFRS required for all	IFRS Permitted for some
Brazil	Local IFRS required for all	IFRS not permitted
Chile	IFRS required for all	IFRS required for all
Germany	EU IFRS	Mix of IFRS/German GAAP
India	Mix of IFRS/Indian GAAP	IFRS not permitted
Netherlands	EU IFRS	IFRS permitted
Russia	U.S. GAAP/IFRS	
Saudi Arabia	IFRS for Banks/Insurance	IFRS not permitted
Venezuela	Modified IFRS	IFRS Required for all

Contribution to Literature

Cooperation and FDI literature have not explained the partial diffusion of these rules and why they suffer from backsliding. Likewise, it is counterintuitive for powerful countries to give up control of reporting standards to a body they cannot negotiate with or vote in when cross border investment is at stake. If the impact of rule changes was relatively small, states allowing boards like the IASB to make rules may make sense, but the changes can be

[19] Data from PricewaterhouseCoopers LLP and Deloitte. Public firms represent one part of the economy IFRS agreements can cover. Private, on the other hand, are those firms not listed on stock exchanges.

substantial. During the last financial crisis, the EU Commission believed changes by the IASB could save Greece from economic doom.[20] The financial power wielded by NGOs such as FASB or the IASB can be arguably greater than that of individual states.

Examining the complex puzzle of financial reporting standards adoption yields several contributions to the literature. First, and most importantly, it adds a new dimension to the literature on diffusion (Berry & Berry 2007; Dobin et al. 2007; Rogers 2003; Simmons & Elkins 2004; Weyland 2007). Theories of international diffusion would not predict backsliding and heterogeneous cooperation associated with international accounting standards. This partial diffusion and backsliding is a result of the political issues I outline in the subsequent chapters. Additionally, international financial standards do not follow the standard S curve associated with diffusion processes.

Second, it gives new insight on the complexities of transactional standards' adoption and explains why discontinuous standards are especially difficult for cooperation (Spruyt 2001; Abbot & Snidal 2001). For example, Abbot & Snidal (2001) theorized distributional problems would hinder transactional standards, but I argue this is only a small part of the puzzle. Transactional standards also suffer from a coordination problem at the firm level and a cooperation problem at a country level that must consider distributional outcomes both domestically and internationally.

[20] There is currently a debate in the finance literature about how much IFRS exacerbated the crises in the EU (See Palea 2013 or the ICAEW report: Future of IFRS (2012)). In general, the statements made during the crises by officials in the EU and the IASB voiced support for modifying standards to save Greece.

Third, it extends the FDI literature and demonstrates a new political determinant of FDI previously unexplored by political scientists (Henisz 2000; Li & Resnick 2003; Stasavage 2002). Since accounting standards are the bedrock on which all foreign investment is built, new political studies of FDI should consider its importance and control for its effects. I demonstrate moderate FDI increases from IFRS and its modified version in chapter 2.

Fourth, in the area of international capital regulation, it uncovers new actors and complements previous research by shedding light on how regulators deal with cooperation and coordination problems for standards that directly affect capital regulation (Broz & Frieden 2001; Oatley & Nabors 1998; Simmons & Elkins 2004; Singer 2007). Private regulators and their interactions with governments have been ignored in this literature. Financial standards are a form of capital regulation since they define how capital entering a country will be valued (Buthe 2008).[21]

Finally, it uncovers a new political dimension to problems of IFRS international spread that largely has only been briefly explored by finance literature using political variables (Fleckner 2008; Griffin et al. 2009; Lamoreaux et al. 2014; Ramanna & Sletten 2009; Zeff 2002 & 2010). This is an adjudication between the political economists that solely focus on governance of IFRS and the finance literature that often ignores political aspects of IFRS. This project tries to approach the problem of international regulatory standards from both points of view.

[21] Buthe (2008) is adamant that institutions like the IASB and FASB are institutions regulating global capital.

Why Study International Standards Countries Violate?

The main message of this chapter is that seemly technical international standards are highly politicized and this has several implications for international cooperation. For a broad understanding of these international problems, the analysis needs to extend to the area of cooperation, coordination, and compliance. Additionally, all accounting or financial standards are political.[22] The political interpretations of value hinder their global use and hinder the broad benefits countries could gain if they were left in the hands of experts and not politicians.

Despite their failures, there is still a substantial amount of adherence to international rules (e.g. figure 1.5). Governments and private regulators do not completely violate agreements, and the international standards countries use tend to benefit them. My goal in the subsequent chapters is to explain why there is a partial adherence and what this might mean theoretically for other international standards when countries attempt to harmonize standards (i.e. move to one standard). In an increasingly globalized world, standards developed by a mix of public and private regulators (like IFRS) may also see increased growth and demand in the future.

Lastly, standards are more similar now than at any other time in history. This project cannot predict the future of standards harmonization though the evidence suggests standards are likely to break down. Instead, my goal is to shed the first light on the political issues of cooperation, coordination, and compliance for rules once thought to be purely technical. As

[22] This seemly bold statement is advocated by numerous accounting organizations such as ICAEW. I can only guess because most political scientists are uninvolved in accounting, there has been so few studies that examine the politicization of accounting besides Buthe & Mattli's work and none that have looked at their piecemeal and partial adoption.

global finance continues to change, these core issues will continue to be as relevant as they have been for the last 60 years.

Chapter 2

Standards of International Cooperation

"*Using International financial reporting standards would turn the keys over to the EU…US [economic] interests trump cooperation*"

-Jim Schnurr, Security Exchange Commission (SEC) Chief Accountant, 2011

"Let me not beat around the bush, it is certainly true that the adoption of IFRS puts a constraint on national preferences in accounting standards."

-Hans Hoogervorst, President of the IASB (EU Regulator), 2015

Partial international cooperation is a characteristic of financial standards and a phenomenon not observed in other international standards such as the metric system[23] or the ISO management system. What drives the wedge between full and partial cooperation are countries that desire transparency for their investments abroad, and those that wish to bend the rules slightly to benefit their domestic firms. These mutually exclusive interests manifest themselves politically through legislation or other government pressures that move the amount of cooperation between countries' regulators. In the US for example, over 1300 government induced changes to standards have been made since 2000. These can be substantial with one in 2016 adding billions in value to AT&T overnight. These changes in these standards affect central elements of the international economy.

[23] For example, countries typically do not use inches for measurement and grams at the same time. This is the process with IFRS on an accounting scale.

By fully cooperating, transparent countries forego their ability to change rules or manipulate values of firms and banks. Partial cooperators, on the other hand, may carve-out large sections of standards, and use other standards that benefit them more. This is similar to a prisoners' dilemma type situation and every country should defect, yet this asymmetric international cooperation has continued for the last two decades. Why partial cooperation and backsliding are tolerated by fulling cooperating countries is a puzzle with international financial standards.

International cooperation on standards becomes an issue of how much of a standard should a country use. This is unlike international coordination (chapter 3) in a few ways. First, in this stage, governments tend to completely dominate the interests of private regulators though private regulators initiate and try to guide the rules and international agreements. For example, the previously mentioned 1300 changes to US standards since 2000 are all products of government intervention, and the US has been working with the IASB on IFRS cooperation for most of this period. For international coordination, when deciding which firms or sectors will use the new standards (at whatever level of cooperation that was previously decided), private regulators tend to be consulted more as shown in the following chapter.

Answering the question of why countries deviate from their agreements and how they reach one financial standard complements research on international capital regulation (Broz & Frieden 2001; Oatley & Nabors 1998; Simmons & Elkins 2004; Singer 2007) and also research related to IFRS spread among countries (Buthe & Mattli 2012; Eaton 2005; Eberle & Lutz 2008; Posner 2009 & 2010; Ramanna & Sletten 2009; Simmons 2001; Veron 2007). For capital regulation, it gives new insight into the role of private regulators and how agreements influence

FDI flows. For IFRS research, it takes the novel approach of not treating all IFRS agreements the same and demonstrating partial cooperation exists. I posit this partial cooperation exists due to economic imbalances and the resulting cooperation between countries is often asymmetric.

Demonstrating that countries reach international regulatory agreements despite a lack of US and EU cooperation speaks directly against Drezner (2007). Drezner argued countries seek international regulatory agreements to maintain their domestic regulatory status quo, but this has not been the case. I demonstrate in this chapter and the following that countries selectively adopt new regulatory standards in order to maximize benefits and these standards are different than their old domestic standards.

Motivations to Cooperate and Defect

In this section, I briefly review the general motivations for cooperation and defection, why these differences do not matter for developed and developing countries, and why I ignore non-cooperators in my analyses. Broadly, economic gains are related to the production of the global public good of financial transparency. As each country adopts IFRS rules (or parts of these rules), the transparency is available to all global actors and cannot be selectively denied to others (i.e. partial or non-cooperators).

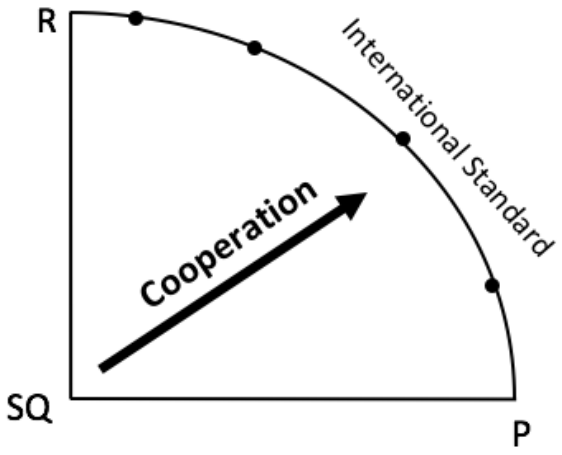
This global public good of financial transparency leads to increased capital flows and trade in goods. These benefits are touted by the IASB and other standards boards and broadly supported in the literature. The increases in investment and trade are typically a small percentage of overall economic activity in a year (Beneish 2012; Chen et al. 2014; Gordan et. al 2012, Marquez-Ramos 2011).

Partial defection, on the other hand, has been ignored in the literature, but political leaders have stated their reasons for deviating. French President Sarkozy, for example, stated in 2008 his success in changing France's use of IFRS "removed a handicap from firms". This particular change removed some restrictions on banks and how they reported debt. Thus, banks that normally had to report full values of government bonds could report the debt at a lower rate (sometimes 30% or less of the actual debt value). On the surface, this carve-out was relatively small, yet it had enormous implications for France's economy. These are the types of carve-outs countries typically pursue.

Furthermore, defections from the intent of agreements and typically cause trouble between governments and regulators. India's government, in 2016 for example, carved-out so many rules that the president of the IASB claimed they were no longer using the same standard.[24] However, most defections from the agreements are, while meaningful, still relatively small to the overall agreements themselves. This chapter is more focused on why countries move away from domestic standards to new ones (like IFRS), but I also include a discussion at the end this chapter about the potential for cheating and how it may evolve in the future.

[24] As of 2015 The Finance Minister, Arun Jaitley, and Parliament are responsible for these carve-outs.

Figure 2.1: Moving to the Pareto Frontier



Differences for Developed and Developing Countries

There is a debate in the literature about the relationship between country development and cooperation on financial standards. All literature treats IFRS cooperation the same when, as I demonstrate, there are multiple levels of cooperation (Chand 2005; Clements et. al 2010; Feleagă & Feleagă 2010). For the purposes of this project, there does not appear to be a pattern related to economic development and the level of cooperation with the EU regulators or other standard setting bodies. Regardless, there are some subtle differences in how these two sets of countries approach cooperation.

Many trade deals incorporate negotiations on financial standards because countries only need to cooperate on a standard best for economic exchanges. However, like in trade treaties, developed and developing countries have different issue expertise and concerns. Developed countries have long histories of creating their own standards before cooperating and understand how to craft new financial rules. On the other hand, less developed countries may not have financial experts and little experience with the development of financial

standards. For example, many of Kenya's basic accounting standards were passed as laws in the 1980s and the country had no agency (public or private) to develop standards until the 2000s.

Furthermore, in less developed countries cooperation with the IASB solves a few problems. First, it makes financial information clear and more credible to international investors and international creditors such as the World Bank (Baskerville 2013; Hegarty et al. 2004; Lamoreaux et al. 2014). Second, underdeveloped countries may lack financial expertise, and cooperation allows the IASB to update their financial rules to those used in the developed world. This also means less developed countries may be more willing to accept rules and cooperate without changes or input on new standards.

International cooperation for a new country standard such as IFRS can be appealing to less developed countries. For the poorest countries[25] with detailed data available, more fully cooperate with the IASB and use an unmodified form of IFRS (Table 2.1). However, while countries in different economic positions may have differing reasons to cooperate, all countries gain economically from using universally understood standards such as IFRS.

Table 2.1: LDCs and IFRS

IFRS	13
Partial Cooperation	5
IFRS Not Permitted	5

Even though less developed countries may be more likely to cooperate fully, this does not define their path of cooperation. Underdeveloped financial markets may see gains from small rule modifications that advantage home firms, but initially this may be less of a priority

[25] Based on the UN's classification of Least Developed Countries as of May 2016.

and less understood by legislators and private regulators. Thus, it is possible there would be considerably less cooperation if all countries had financial expertise and lobby groups with financial expertise and rule development skills.

Despite gains, not all countries choose to cooperate on a standard and some may use two international standards. For example, countries such as the US, India,[26] and Indonesia use their own standards while other countries such as Switzerland and Panama allow their firms to use either US (GAAP) or EU standards (IFRS). For countries currently not cooperating, all have been moving toward some form of IFRS.

What About Non-Adopters?

Within the subgroup of countries that do not have a formal agreement to use IFRS with the IASB, almost all countries have long term plans to work with the IASB and most are actively discussing adoption with the IASB. The exceptions tend to be failed states (e.g. Somalia, Sudan, etc.) or countries with more extreme regimes such as North Korea. The analysis for countries in the process of developing plans to adopt IFRS (i.e. make some type of formal or informal agreement with the IASB) is difficult because it is unclear how much they will cooperate and when cooperation will occur.

Additionally, the analysis of non-cooperating countries with plans to adopt is impossible since it is unclear if technical difficulties or economic concerns are slowing down the adoption process. In countries such as the US, officials[27] have made statements citing economic and

[26] At the time of this writing, India still does not permit IFRS, but it may use them in 2017.
[27] For example, see the quote at the start of this chapter by Jim Schnurr

technical concerns. From these statements, it is impossible to determine the eventual level of cooperation and these countries claim they are on the path to use IFRS. Thus, it is difficult to state these countries are not cooperating because they are currently in some low level state of cooperation with the IASB. Most have not completely rejected IFRS or cooperation with the IASB.

For the purposes of this chapter, I can only speculate on why countries are slow in their cooperation efforts and how much they will eventually cooperate. Furthermore, my analysis demonstrates why countries cooperate partially or fully after (and only after) they have made the transition to using IFRS.

Economic Gains from Cooperation

Cooperation with the EU's private standards board (IASB) on international standards (IFRS) is driven by several factors, but in this chapter I focus more on the economic gains and what they mean for the relevant actors. In particular, I believe countries sending investments abroad will want transparency (i.e. full cooperation) and countries importing capital will want to bend the rules a little (i.e. partial cooperation) to gain more. Thus, in this chapter I examine the countries fully cooperating with the EU regulator and those partially cooperating.

International cooperation and economic imbalances

I posit there are two economic considerations pushing countries to partially cooperate with the IASB (i.e. modifying their international agreements) both linked to controlling a country's economic narrative: First, in the long run, countries may partially cooperate to

present domestic firms more favorably relative to their foreign competitors. Second, in the short run, countries may partially cooperate to obscure financial data during economic crises. Since few of the 120 countries that cooperate on IFRS have frequent economic shocks, in this project I focus on the first factor and how and why it affects international cooperation.[28]

In most cases, partial cooperation[29] is simply a country excluding larger rules such as those relating to banks or insurance, and most firms elsewhere in the economy are using the same rules as their international partners (See Figure 1.2). It is not about who in the economy uses the rules, but simply about which rules are used (chapter 3 discusses the question of which sector or firms). With partial cooperation, there are still substantial gains from financial transparency between countries with minor exclusions for banking and insurance that impact international capital flows. This means the rules are the same between most firms across countries that use IFRS and this is why countries are able to agree on a unified set of standards despite disagreements in certain sectors.

Disagreements on areas within standards such as IFRS are initially driven by concerns regarding economic imbalances. As previous studies have demonstrated, IFRS has benefits for both FDI and trade in goods (Beneish 2012; Chen et al. 2014; Marquez-Ramos 2011) and countries would like to maximize these benefits especially when there are imbalances. To maximize the benefits of international standards, countries may be more likely to choose optimal rules that allow them to present their firms as better than foreign competitors. This

[28] In a separate article, I focus on the second topic.
[29] In the accounting world, partial cooperation is typically referred to as "local IFRS" meaning the country has replaced some of IFRS rules with its own. The big four global accounting firms tend to use this language to describe large deviations from the IASB's rules.

could be done to help any sector or large firm that struggles with foreign competition. For example, the US government's approval of mark to market accounting for Enron[30] added billions to its value and brought in substantial foreign investment. Rule carve-outs for sectors or firms drive partial cooperation on IFRS.

The countries that fully cooperate and desire full cooperation abroad will be those that are net exporters of capital and have less economic turmoil. In general, these countries will want transparency in their investments abroad and their trade partners. This will prevent their domestic firms from entering into bad agreements with foreign investment partners and will ensure financial transparency in times of crises. For developing countries, there may be more incentive to fully cooperate if they have large amounts of capital abroad and they have no history of standards development (i.e. no experience making their own standards).

Some countries have an incentive to cheat and renege on agreements, but mainly those experiencing economic pressures will move toward partial cooperation. The pressure to manipulate international regulatory agreements may be domestic and international. For example, the IMF may exert pressure on countries to correct their balance of payments issues while other international creditors or investment partners may ask for the same. Domestically, like the British banking example in chapter one, firms that lose foreign investment due to new

[30] At its peak, Enron was worth $70 Billion, mostly due to mark to market accounting, and Enron's creative use of this type of accounting. This was 70 times its earnings and tens of billions more than it would be worth under different accounting schemes. Some illegal activity contributed to this, too. In terms of foreign investment, as just a small example of this, Credit Suisse (Swiss Firm) invested at least $2 Billion in Enron, but there were also many other foreign investments lost. The court battles to recoup this money certainly did not help US GAAP.

rules may ask their private regulators or legislators to follow a path of partial cooperation with the IASB.

The countries engaged in standards cooperation may seem to be in a prisoners' dilemma type scenario, yet many countries do not defect. The puzzling lack of defection stems from enormous gains countries receive using a common set of standards. These standards provide the global public good of transparency for the most part except on the margins where countries cheat slightly. Overall, the benefits from cooperation should allow countries to overlook partial cooperators. However, partial cooperation, as I call it in this project, has become more than marginal in some countries such as India, so full cooperators may change strategy in the future.

The countries fully cooperating are hoping their partners will follow all the rules while the partially cooperating countries are reneging slightly to gain extra benefits. If this true, I expect partial cooperation, mostly induced by governments, to be testable in two hypotheses:

> *H1: Capital importing countries will be more likely to cooperate partially than cooperate fully.*
> *H2: Countries with larger trade deficits in goods will be more likely to partially cooperate than cooperate fully.*

The fully cooperating countries may find that using mostly the same standards outweighs the potential losses from further defection. Thus, they sustain this asymmetric cooperation with the belief their partners will later fully cooperate or the losses are too small to push them toward defection.

This economic pressure may only be a necessary condition for partial cooperation and not sufficient by itself. It is possible other factors such as mistrust between regulators are also

necessary to move countries towards partial cooperation. I explore this and economic pressures in the context of Japan-EU cooperation later in this chapter.

While two balance of payments issues are related (FDI and trade), I primarily examine FDI for capital imports and only use larger trade deficits of goods (>3% GDP). My focus on trade in goods stems from the literature stating IFRS influences the trade of goods, not services (Marquez 2009). However, for both capital and trade, I use several different measures. Together, they address economic imbalances countries may try to selectively correct by partially cooperating on international financial standards.

Furthermore, these hypotheses address the substance of IFRS agreements (i.e. what is at stake) for countries cooperating on international standards. Empirically, it has been demonstrated that both trade and FDI experience increases following a country's cooperation with the IASB, but it has been unknown if this influences how much a country is willing to cooperate. Previous analyses of IFRS cooperation in the literature have only focused on governance issues from within standards bodies instead of distributional consequences of IFRS.

If countries partially cooperate because of economic imbalances, it should also be true that these countries gain more in terms of FDI or trade in goods. Political leaders[31] have stated they believe partial cooperation will garner benefits, but it is unclear if this true without testing. Thus, if this prisoners' dilemmas setting does exist, the typical gains following IFRS use should be more for countries manipulating the rules (i.e. partially cooperating). If there are no

[31] Gordon Brown and others are briefly discussed after the statistical analyses in the next section. India's officials (both the finance minister in 2014 and Parliament) would also be good candidates to discuss concerning "perceived" benefits from cheating. I also briefly mention them elsewhere in this project though they deserve much more attention.

additional gains from partial cooperation, other factors may be more influential in determining the pattern of partial cooperation. Thus, a third hypothesis follows:

> *H_3: Countries partially cooperating will experience more benefits immediately following IFRS cooperation relative to countries that use the full version of IFRS.*

In sum, I posit countries are motivated to cooperate on IFRS for economic reasons, and those with economic imbalances will bend the rules to help correct issues of trade and investment. If this is correct, partially cooperating countries will be more likely to have economic imbalances and these partial cooperating countries will gain more than their counterparts that choose to cooperate fully with the IASB.

Cooperation Data and Analysis

To test these hypotheses and others in this project, I constructed an original dataset of country cooperation on International financial standards from 1980 to 2016. Historically, cooperation has been operationalized in different ways that stem from the classifications of countries' standards use from the Big Four accounting firms: Deloitte, Ernst & Young, KPMG, and PricewaterhouseCoopers. These accounting firms have the largest global presence and perform most of the audits required for publically traded companies in the U.S. The classifications of standards adoption in this project are from PricewaterhouseCoopers and Deloitte.[32] I use these accounting firms because of their publically available classifications and because Deloitte's global presence is the largest.

[32] Deloitte's information is available here: http://www.iasplus.com/en/resources/ifrs-topics/use-of-ifrs, PricewaterhouseCoopers' information: http://www.pwc.com/us/en/issues/ifrs-reporting/publications/ifrs-status-country.html

In addition to using the publically available data for IFRS use from PricewaterhouseCoopers and Deloitte, rich data covering most countries and their IFRS cooperation is available from the IASB.[33] The IASB's publically available IFRS data includes more nuance information about deviations and augments the data from PricewaterhouseCoopers and Deloitte. Together, this data includes the particular deviations from IFRS and the year a country adopted its standards. Data for private regulator independence is not always available, but is usually clear from private regulator's websites. I discuss more in chapter 4 what it means for a private regulator to be independent.

Dependent Variable Construction

The data from PricewaterhouseCoopers, Deloitte, and the IASB also make it possible to discern countries' cooperation at a national level (i.e. mandatory IFRS use or the same rules for all firms), the market level (i.e. some publically traded firms or private firms), or the sector level (i.e. use IFRS for one sector such as banking). For this chapter, I analyze national level cooperation while the data concerning sectors and firms is utilized in the coordination section (chapter 3). This national cooperation variable is coded as 1 if a country is partially cooperating and 0 if a country is fully cooperating.

Using this dependent variable, the analysis for hypotheses 1 and 2 in this chapter uses a logit model for countries in 2014. I examine IFRS use for 88 countries in 2014, and all states in this sample have stayed within their decided paths of either full or partial cooperation for at least 10 years. This is a simple cross section of data and not a time series. Additionally, I

[33] Found here: http://www.ifrs.org/use-around-the-world/pages/jurisdiction-profiles.aspx

determine if since the lawful start of IFRS (or international regulatory treaty start date) a country moved to partial cooperation (coded as a 1) or if they continued fully cooperating (coded as 0).

The outlier is Venezuela which switches from full to partial cooperation almost immediately and this has been removed from the analysis. Because the countries analyzed either start at full or partial levels of cooperation and stay there during the time period analyzed, this study cannot benefit from a survival type analysis (there is more variation at the subnational levels that is outside the scope of this current chapter and project).

To determine increases from FDI and trade after IFRS cooperation for hypothesis 3, I use fixed effects models by country and year. The dependent variable in the FDI analysis is total FDI inflows relative to GDP, and the dependent variable for trade is goods traded volume relative to GDP. This approach is similar to studies concerned with the economic impact of IFRS in accounting and finance journals (e.g. Lasmin 2012).

Independent Variables & Robustness

To examine capital inflows, my independent variable of interest is capital importer status which I create using a dummy variable from the IMF's International Financial Statistics dataset. Countries are coded as capital importers if they receive more FDI inflows than outflows (i.e. the net FDI variable in the IMF's dataset). Portfolio investment would be a much better

measure, especially with accounting standards, but the data in poorer countries is severely lacking[34] and limits any quantitative analyses.

As a robustness check and to capture investment flows on a continuum, in separate models I analyze: (1) capital inflows in 2005 US dollars, (2) net FDI inflows in 2005 US dollars, and (3) FDI inflows relative to GDP. Because these are not perfect measures of foreign capital reliance and do not capture some of the nuances of foreign investment, I also control for countries' ability to borrow foreign capital in the analyses.

To examine traded goods and IFRS, I use two measures for trade deficit in goods. First, I use the World Bank's net trade data in goods and only code countries as being in a trade deficit if their negative net trade balance. Using this classification, I code countries with trade surpluses as 0 and net trade importers as 1. This coding scheme is used in the logit analysis in table 2.1 (below) while trade relative to GDP (a continuous variable) is used in the fixed effects models in table 2.2. Second, I also use the net traded goods in 2005 US dollars.

For hypothesis 3, the main independent variables are IFRS and modified IFRS in separate models. If a country initially partially cooperates, the modified IFRS variable is coded as a 1 for years after cooperation and a 0 before. Similarly, if a country fully cooperates, the IFRS variable is coded as a 1 after for years after cooperation and a 0 before. These models include two years before and after cooperation for 80 countries from 1999 to 2010. The cross sectional data here are more comprehensive than other analyses within the literature (Beneish 2012; Chen et al. 2014; Marquez-Ramos 2011).

[34] Sometime before depositing this dissertation, I will see if 2016 data is more available. The last logit models I ran with portfolio investment were from 2010 and the N was quite small.

For the models within this chapter, the FDI, trade data, and standard economic controls are from the IMF's International Financial Statistics dataset and the World Bank. The independent variables market value (total value of a country's stock market), and access to credit (the amount borrowed by a country's banks) are relevant to IFRS cooperation and are considered in other analyses. Inflation, GDP (in 2005 US dollars), and polity score are meant to control for economic conditions and the political setting of cooperation.

A Note on Reverse Causality

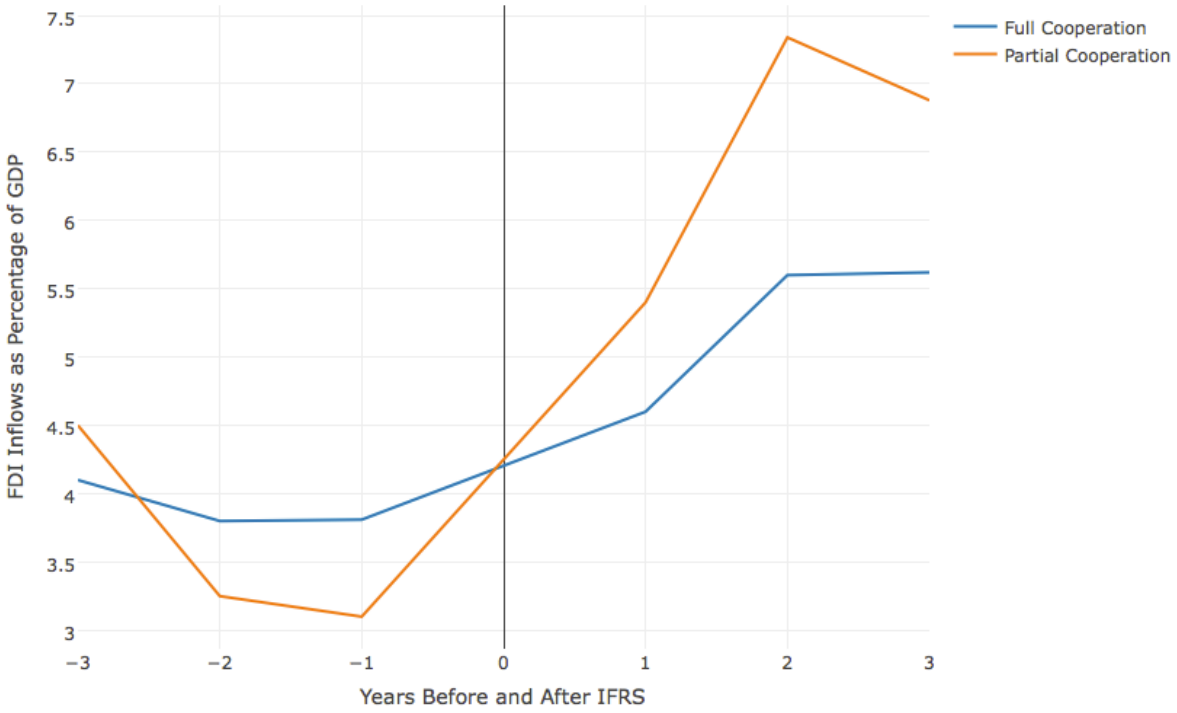
The literature regarding country cooperation on accounting standards and various investment flows leans in the direction that reverse causality is not an issue (Da Silveira & Barros; Efobi & Nnadi 2015; Kim & Shi 2012; Jayaraman & Kathari 2015; Marquez-Ramos 2011). These studies indicate that higher FDI inflows do not lead to IFRS, but instead IFRS lead to higher investment inflows. However, some evidence exists of reverse causality for international compliance and ownership in foreign firms (Bova & Pereira 2012). I discuss this further in chapter four and its relevance to compliance for international agreements concerned with standardization.

Moreover, logically it follows that IFRS lead to higher investment flows and not the other way around. IFRS provides the transparency that investors desire to invest more in a foreign country. Countries with already high levels of investment do not need to placate foreign investors by adopting IFRS (the US and Switzerland are good examples). Furthermore, IFRS has a well-established average treatment effect of boosting FDI by a few percent (relative to GDP) regardless of a country's previous investment conditions.

Partial cooperation and gains

Agreements with the IASB typically have a period of a two or three years before the country's private agency or government body needs to implement new rules. During this time, some countries step away from their original agreements to fully cooperate (also occurring in financial crises). Once rules are implemented, depending on which standards are used, it defines the level of cooperation the country's private agency or government body will have with the IASB in the future. As many studies demonstrate, the average effect of ratifying or joining IFRS is almost always beneficial for FDI, trade in goods, and sometimes foreign aid (Beneish 2012; Chen et al. 2014; Gordan et. al 2012, Marquez-Ramos 2011). However, the literature does not disaggregate IFRS cooperation to ask: Is all cooperation equal? Figure 2.2, which is only one measure of FDI, shows the inflows of FDI before and after IFRS for full and partial cooperation. This is somewhat illustrative of the dozens of studies that confirm IFRS benefits FDI. In figure 2.2, partially cooperating countries seem to gain a little more. Does this motivate countries to cooperate differently on an international standard?

Figure 2.2: Average FDI Inflows Before and After IFRS



Below, table 2.2 shows the results of a logit regression with partial cooperation as the dependent variable. Across all measures of FDI, partially cooperating countries are more reliant on capital imports than countries fully cooperating. For the measures of trade in goods in the models, three are significant while one is in the right direction but falls short of significance. This may be a result of my relatively small sample in terms of countries and years whereas other studies linking trade and IFRS are more expansive.

These preliminary results suggest that countries with larger trade deficits in goods and those more reliant on FDI are more likely to partially cooperate on international regulation. A closer examination of the data suggests these countries that partially cooperate are diverse such as Australia, Greece, and Argentina, but they mostly have larger economic imbalances. Also, from the sample, few countries have moved to full cooperation or from full to partial after

their agreements and in part this is due to IFRS still being a relative new phenomenon. However, a future analysis may reveal once countries have subdued economic issues that they move in favor of full cooperation or that full cooperators move toward partial as their economic imbalances begin. Some evidence of this phenomenon exists in the EU, but there is not enough data available for a larger study.

The results in table 2.1[35] also support the theory that capital exporters will be more likely to fully cooperate. Thus, countries with capital abroad will want more transparency to ensure their partners do not cheat. As with capital importers, in the long run it may be that these countries shift their stance toward IFRS as they have economic imbalances and move toward partial cooperation. However, just as with countries partially cooperating, the relatively new phenomenon of IFRS makes it difficult to discern future patterns.

If partial cooperation is driven by economic imbalances, there should be greater benefits in terms of trade and FDI for these countries. To clarify, countries must be getting some benefits economically by positioning themselves as partial cooperators among those that fully commit to working with the IASB. The coefficients in table 2.3 for full and partial cooperation demonstrate increases in FDI inflows (relative to GDP) and the increases in international trade following the adoption of IFRS. The results that are in line with what hypothesis three would expect.

[35] I rescaled some variables. Also, positive capital account is at .07 p-value (in model 4) and Net Trade is at .06 (model 3). However, one tailed tests (which these should be) place these well below the standard .05 cutoff. Capital importer in Model 1 is a bit weaker at .07.

Table 2.2: Partial Cooperation and Economic Imbalances

	Dependent variable:			
	Partial Cooperation			
	(1)	(2)	(3)	(4)
Capital Importer	1.093$^{\bullet}$			
	(0.705)			
Trade Deficit	1.310**			
	(0.664)			
Positive Capital Account		0.622*		0.606**
		(0.313)		(0.290)
Net FDI			0.018**	
			(0.008)	
Net Trade		0.014*	0.012**	
		(0.008)	(0.006)	
External Trade Balance				0.013*
				(0.007)
GDP	0.573**	0.791**	0.713**	0.982**
	(0.162)	(0.210)	(0.190)	(0.272)
Credit Access				-0.007
				(0.006)
Polity Score	0.060	0.068	0.081	0.081
	(0.048)	(0.057)	(0.055)	(0.061)
GDP Growth	0.125	0.200	0.200	0.044
	(0.118)	(0.151)	(0.142)	(0.113)
Inflation	-0.206**	-0.222**	-0.315**	-0.325**
	(0.089)	(0.105)	(0.102)	(0.127)
Market Development	-0.250**	-0.284**	-0.408**	-0.382**
	(0.116)	(0.135)	(0.143)	(0.160)
Observations	101	85	94	82

Table 2.3: Gains After Full and Partial Cooperation[36]

	Dependent variable:			
	Trade Increase %		FDI Increase %	
	(1)	(2)	(3)	(4)
Full Cooperation	4.247***		2.553*	
	(1.128)		(1.307)	
Partial Cooperation		6.813***		3.930**
		(1.387)		(1.644)
Economic Growth	1.074***	1.042***	0.214	0.198
	(0.216)	(0.211)	(0.247)	(0.246)
GDP	-0.000*	-0.000	0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)
Polity Score	-0.025	-0.031	-0.006	-0.009
	(0.109)	(0.107)	(0.126)	(0.126)
Credit Access	-1.157***	-0.809**	-0.347	-0.141
	(0.400)	(0.397)	(0.461)	(0.468)
Market Value	0.110***	0.097***	-0.099***	-0.106***
	(0.026)	(0.026)	(0.030)	(0.030)
Inflation	0.747***	0.643***	-0.028	-0.090
	(0.246)	(0.239)	(0.283)	(0.280)
Observations	261	261	267	267
R^2	0.322	0.354	0.071	0.080

[36] The J term here (or amount of years) is 3 per country. I may change this to cross section and eliminate the time series in the next iteration of this project.

Furthermore, the results regarding full cooperation are widely supported in the literature,[37] but the distinction between those that fully cooperate and those that partially cooperate is not made in other analyses of IFRS, FDI, and trade. The partial cooperators gain more in both trade and FDI, and this lends support to hypothesis 3 that partial cooperation or rule bending is beneficial for countries that are experiencing economic imbalances.

These results should not be surprising given the statements on rule carve-outs, or partial cooperation, from the IASB president during the most recent financial crises. Hans Hoogervorst stated in 2011 that "IFRS changes [partial cooperation] can help Greece's crisis by devaluing debts." The fact bank debts can be politically defined should terrify financial markets, but, as with all accounting, the numbers on financial statements are to an extent a product of political processes (usually international politics). Rule bending like this is not limited to only bank debts but can be expanded to make any sector or group of firms seem more financially stable and healthy.

Additionally, leaders push for these carve-outs because they believe there are net benefits. For example, Gordon Brown, Nicholas Sarkozy, and the US Congress have made declarations to change financial standards for economic gain. After the financial crisis, the US congress passed the "Emergency Economic Stabilization Act" that replaced many FASB (private board) functions with SEC (government board) and destroyed the FASB's independence. This act established new accounting practices that would make US banks more competitive and started a small "accounting standards war" with the EU. Afterward, with pressure from Sarkozy, the EU Commission forced IASB rule changes so their banks would not be at a disadvantage.

[37] The percent increases for FDI and trade are similar.

The goal in both cases was to gain capital and extra investment in the wake of an economic crisis.

From the results, it is clear countries benefit, though in varying amounts, through the use of IFRS. The IASB has helped push countries toward this new Pareto frontier. Although political challenges have changed the flow of cooperation, most of the world using the same standard is an achievement even if countries disagree on some larger points within the standard. The alternative is a world where each country has incredibly different rules for all industry and sectors, which was a reality until the late 1990s, and this created a challenge for international investment and trade. Objectively the world is better off (in terms of economic health) with these international standards even with disagreements. To put these disagreements into better context, I next examine Japan's 2007 Tokyo agreement with the IASB.

Results in the context of the 2007 Tokyo Agreement

In 2007 Japan's private standard setting board, the Accounting Standards Board of Japan (ASBJ), signed an international agreement with the IASB (EU regulator) to cooperate on IFRS. After this agreement was signed, Japan's government changed its private regulatory agreement to partial cooperation. In this section, I briefly outline the process to illustrate how partial cooperation occurs within the data and analysis presented in this chapter. In general, the main point is cooperation levels are a product of economic imbalances and both international and national politics.

Following the 2007 Tokyo agreement, Japan faced its first large trade deficits since the 1980s (2010-2016) and decreasing net FDI balances that turned negative by 2010. These large economic imbalances did not exist prior to the ASBJ (Japanese regulator) signing the Tokyo agreement. Following these imbalances, the Japanese Business Accounting Council (BAC), a government agency, stated it needed to review the agreement and how IFRS would impact Japan's economy.

Without the intervention of BAC, it is likely Japan would have continued on a path of full cooperation. The two private standard setting agencies (the IASB and ASBJ) only needed to solve accounting disagreements, not political ones. As Japan's economy faltered from the fallout of the global financial crisis, the BAC (Japanese government agency) began its review of the Tokyo agreement. Turmoil during this time within the EU, which included rule carve-outs and noncompliance (discussed more in chapter 4), raised many questions about how much other countries would cooperate with the IASB as well. While under review by the BAC, the Japanese private standard setter (ASBJ) could not make substantial moves to fully cooperate with the IASB.

When the BAC released its report in 2013, it was clear from its recommendations that the group had concerns regarding the EU's control of IFRS and how it may impact Japan's FDI. To this end, BAC's first recommendation was the creation of an endorsement process for new standards from the EU (i.e. Japan has the right to alter any new standard). The previous agreement between the ASBJ and the IASB allowed for new standards from the EU to immediately become rules within Japan without oversight. The BAC stated this process would

protect Japan and its investors. This in line with what I have posited regarding country motivations for partial cooperation.

Secondly, the BAC report stated Japan should alter some items regarding firm valuation and how income is determined (rule modifications[38]). Again, countries concerned about controlling their financial narrative, given its impact on trade and investment, should be concerned with firm valuation and reported incomes. The changes to IFRS regarding these rules were similar to the US rules during the 2008 crisis. Arguably, these rules made US firms seem more attractive to international investors.

Lastly, the BAC recommended the ASBJ back away from requiring Japanese companies to use IFRS and instead allow Japanese firms to voluntarily use the standard if they choose. This was a departure from the original agreement that required Japanese firms to use IFRS and it also meant there is no definitive timeline for the new standard in Japan. The changes are summarized in table 2.4 below.

Table 2.4: BAC Changes to Tokyo Agreement

Terms	Tokyo Agreement	BAC Change
IFRS Use	Required	Voluntary
New Rules	No review	Mandatory Review
IFRS Version	Pure (IASB Rules)	Modified Sections

[38] These also show up in Deloitte's most recent report on G20 modifications to IFRS or partial cooperation with IFRS.

From these changes it is possible to discern how partial cooperation among private regulators becomes a reality when governments intervene. While private regulators that rely on government funding or corporate donations (discussed more in Chapter 4) may be more likely to modify standards for reasons of national interest, many instances of partial cooperation are from government action as in Japan. However, it is not always a government regulator trying to protect national economic interest. Sometimes a national legislative body, such as the US congress, hinders full cooperation between private regulators.

Furthermore, in Japan's case it may be that the initial economic imbalance was a necessary condition, but the mistrust of the EU regulator and the global economic downturn were also necessary conditions for hindering cooperation. Together, these conditions may have been sufficient to cause the intervention by the BAC and its emphasis on protecting the interests of Japanese firms and the Japanese economy. In sum, the actions of the BAC on behalf of the Japanese government were meant to protect Japan and partially cooperating with the IASB achieved this.

In the context of Coordination and Compliance

The modified sections of the Tokyo agreement, like other IFRS agreements, tend to be sticky in the long-run (chapter 5 discusses this topic more thoroughly). After a first round of revisions, the bigger rule carve-outs stay and less severe (or smaller) cooperation carve-outs occur in the future. This long-run stickiness is the same for coordination (discussed in the next chapter). Coordination is also typically decided in the first few years of country adoption in the

same way. Compliance, on the other hand, tends to be fluctuate more in the short term and countries' compliance tools impact how cooperation and coordination unfold.

The BAC modifications gave the Japanese government a review process (formally called endorsement) for new international standards. These review processes are used for short-term noncompliance (as discussed in chapter 4). When political leaders lack the ability to influence compliance, cooperation and coordination carve-outs can be more severe due to their stickiness. Japan, for example, took almost 7 years to finalize its approach to cooperation with the IASB, and coordination, as discussed in the following chapter typically takes several years to change.

While it is impossible to know the level of cooperation in Japan without a short-term mechanism to influence compliance, it is likely the cooperation carve-outs (i.e. modified sections of IFRS rules) would be greater. Within the data, the countries with the ability to influence short term compliance also tend to have less severe cooperation or coordination carve-outs.

International Standards and Cooperation

On the surface, developed and less developed countries may have the greatest divergence in terms of motivation for using the IASB's standards and cooperating internationally, but the real issues of cooperation stem from countries' economic conditions. Economic conditions are rarely so different that countries cannot use the same standard, in fact most countries use IFRS, but the economic conditions determine the level of cooperation once a standard is chosen by a country's private regulator or relevant government agency.

Furthermore, even at low levels of cooperation, there is still broad comparability between firms in different countries that did not exist before.

At the moment, the acts that are categorized in this project and by the Big Four accounting firms as partial cooperation have not placed serious strain on one international standard holding dominance. The issue, which may be developing now, is how will cooperation continue in the future when rule carve-outs in some countries become larger or substantially affect firm comparability. IFRS is only good as an international standard as it makes cross border investment and trade possible, but large carve-outs in the future may put this at serious risk. The president of the IASB has already claimed India's government has deviated too much to call their standards IFRS.

In a sense, there are already different versions of IFRS in the partial cooperation set of countries. For example, many countries in the EU use what are called "EU IFRS" and this name denotes the particular set of international rules many EU countries have ignored. This is also the case with countries like Brazil or Russia and other developing large economies. Thus, it may only be a matter of time before the world breaks into several standards, which are all based on IFRS, that capture trends in different regions. With increasing regionalization, NGOs such as GLASS (Latin America, PAFTA (Africa), and AOSSG (Asia) may become more powerful, or countries may move once again toward US standards as they did prior to 2001. Another possibility is countries will then move away from the Pareto frontier and back to a suboptimal point where less than half of the firms are comparable globally in a meaningful fashion.

It is likely the countries that have yet to use IFRS are waiting to see how cooperation unfolds among those that fully commit to working with the IASB and those that take the partial

approach. If the standards continue to breakdown more, it is also possible countries could shift back toward the US standard (GAAP), and this would be similar to the late 1990s when more firms across the world used US GAAP than an international standard.

However, despite the disadvantages and possible demise in the future due to these carve-outs, partial cooperation may be necessary for IFRS and the IASB to reach more countries. To clarify, without the option of partially cooperating and using an international standard, many countries may have opted to continue to use their own standards and this would have made the world worse off in terms of financial transparency. Thus, it may be a strategy of regulators like the IASB to allow partial cooperation so they may reach a broader audience even if new countries only use 80% or so of the rules for a portion of their firms.

The pattern of partial cooperation is not entirely dissimilar to the findings on countries committing to trade agreements. For example, countries with trade imbalances are less likely to cooperate through the WTO to find solutions to rebalancing (Frieden 2009; Marchetti et. al 2012). Likewise, there are regional similarities in regards to financial standards cooperation and trade cooperation. For example, much of the EU uses the same financial standards and the same version of IFRS. This is also true for sections of Asia and Africa.

Unlike the WTO or trade agreements, it is unclear the IASB can work to make itself a global organization capable of addressing issues of partial cooperation.[39] The recent moves by the IASB to give regional organizations such as GLASS, PAFA, or the AOSSG a place to discuss issues have fallen short of giving the organizations voting power. Other regions in the world

[39] It is also unclear sometimes if the WTO can address larger global trade problems, but there is at least a formal structure for settling issues of trade within the institution.

have one seat on the 14-person panel that decides new standards for IFRS. It is difficult to imagine one representative can accurately voice all the concerns of North American governments and firms.

In addition to the internal politics of the IASB, other countries may not fully commit to IFRS since the EU Commission and EU parliament are currently fighting for which EU body will approve new standards. Political independence (discussed in Chapter 4) would allow countries to put more faith in the IASB and likely increase full cooperation if a more globally representative panel was apolitical. However, with economic gains at stake and no truly global organization to address grievances, it is likely partial cooperation will increase in the future. Whether or not partial cooperation will fragment the single standard so much countries move away from the Pareto frontier is an open question.

Finally, while this analysis does not cover ever potential political issue that leads to partial cooperation among states working toward a common standard, it does touch on the economic and political sides of the story at the same time. This has been nonexistent in the literature. Any future analyses that discuss the complexities of IFRS cooperation must consider both the substance of the agreement and how it impacts countries and the governing structures both in the IASB and countries (i.e. private regulators and government regulators). These analyses will be more fruitful than analyses touching on one side as seen currently in the finance and political science studies.

Chapter 3

Political Pressures and Firm Coordination

"It is easier to compare a Brazilian retail company with a Brazilian mining company than it is to compare it with a European retailer."

-Hans Hoogervorst, IASB President, 2009

"I think there are a lot of jurisdictions using IFRS where it is pretty clear the standard setting process has been under political control … [geared toward] policy making, as opposed to … investors."

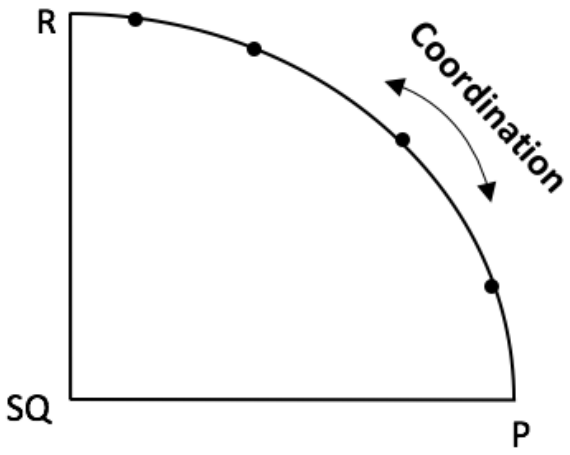
-Tricia O' Malley, Chair of the Canadian Accounting Standards Board, 2011

Once countries agree to an international standard and the level of cooperation, how do countries select or coordinate which sectors or firms to include or exclude? This question is not about which standards (i.e. level of cooperation) are used as discussed in chapter 2, but rather who uses the standards within a country as part of an international agreement (e.g. IFRS). IFRS agreements have distributional consequences depending on what group of actors must follow the international agreement. Using the same standard is Pareto optimal, but there are many points along the Pareto frontier[40] because countries manage international standards differently sometimes for their individual firms, sectors, and public and private markets. This coordination problem for IFRS is complex because the number of equilibria along the frontier is high and

[40] Here I refer to the coordination problem and moving along the Pareto frontier in the same way as Krasner (1991).

changing constantly with new developments in what parts of countries' economies use standards.

Figure 3.1: Moving along the Pareto Frontier



The analysis of selective application of IFRS within countries complements previous work on the politics of international standards and their spread (Buthe & Mattli 2012; Eaton 2005; Eberle & Lutz 2008; Posner 2009 & 2010; Ramanna & Sletten 2009; Simmons 2001; Veron 2007). If countries agree to an international standard to represent their financial health, it may be fruitful to understand how countries selectively decide to use standards for only some sectors or markets especially since these standards impact FDI, trade, ease of business, and transactions with foreign partners. Additionally, it may be helpful to understand what the distributional consequences are internationally for standards selectively applied to parts of an economy. Prior analyses treat IFRS agreements as applying the same everywhere once a country moves toward using the standard with the IASB, but just as there are meaningful

differences in how the rules are bent (chapter 2), there are also meaningful differences stemming from who uses the rules.

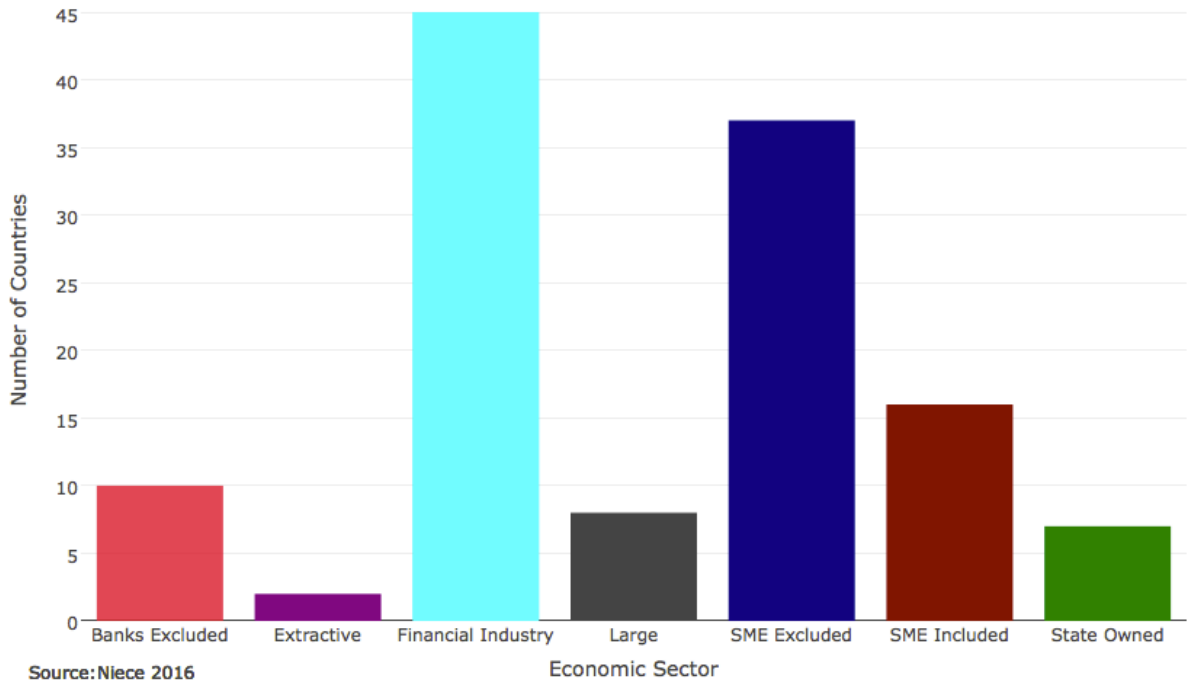
The selective use of regulatory agreements is also overlooked in other works such as Drezner (2007), Fioretos (2010), and Simmons (2001). For example, Drezner posits maintaining regulatory status quo is a key driver of international regulatory agreements, yet many countries change entire sectors to take advantage of rules that benefit them the most. Ignored in Drezner's analysis is the way private regulators give input with government officials to formulate policy. Similarly, Simmons' theory that market hegemony drives regulatory outcomes fails to explain why there is a lack of countries selectively using US rules for key economic sectors.

The differences are substantial across countries for which domestic industries use the agreed upon international standard. For example, from my original dataset, 45 countries use IFRS for only their financial industries and 20 require IFRS only for publically listed (on stock exchanges) banks or insurance firms while their private financial firms (not listed on exchanges) can use different standards. On the other hand, 16 countries require IFRS only for their small and medium sized businesses (SMEs). Table 3.2[41] has a summary of the number of IFRS agreements that mainly cover one sector. Some of these agreements will cover an entire

[41] This data is from the IASB's 2014 country reports. For countries excluded from that report, the most recent data from 2015 from the IASB plus organization was used. Each column represents an agreement between the IASB and government (or private regulator when appropriate) when the agreement specifically singled out the inclusion of that sector with the exception of the "no banks" column. The "no banks" represents the agreements that specifically exclude financial firms such as banks (though usually insurance is included, too).

market, such as a stock exchange, but also single out private firms with high revenue or importance to also use IFRS (large private in figure 3.2).

Figure 3.2: International Coordination and Country Sectors

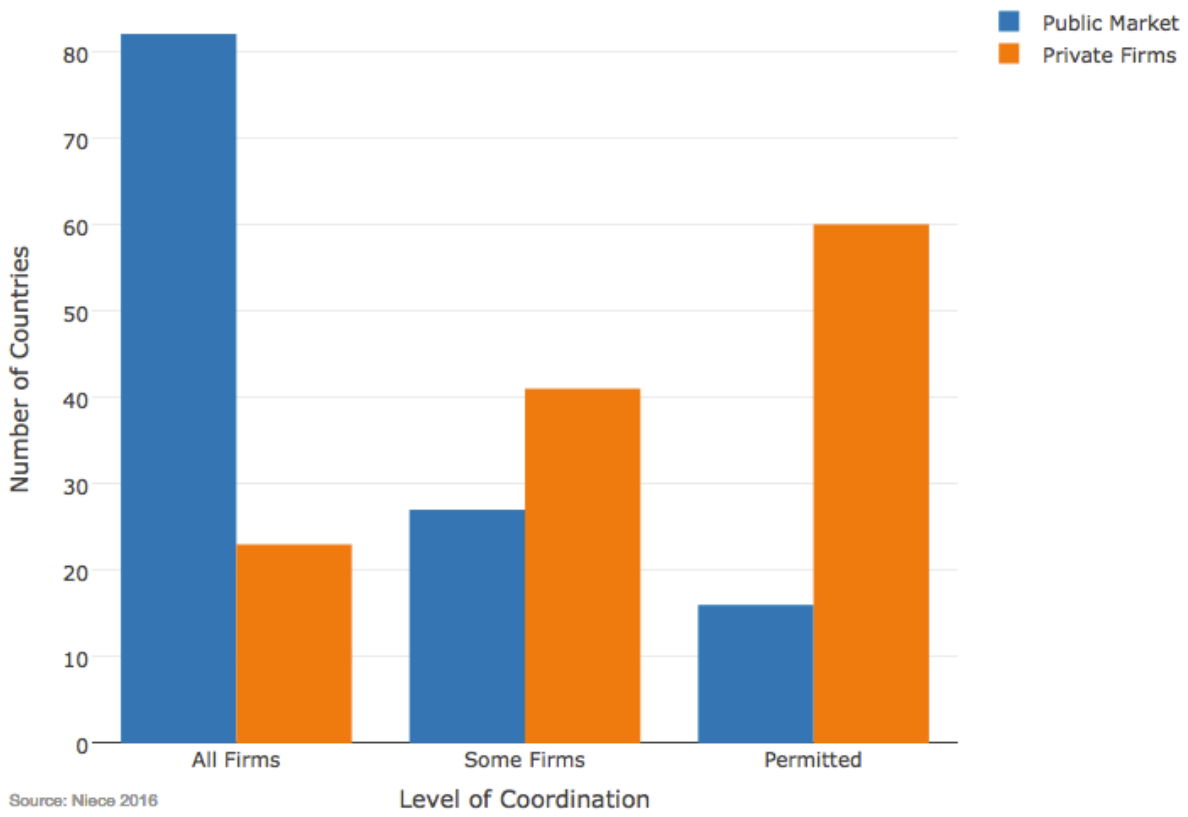


Beyond the different sectors in an economy that may use IFRS, countries sometimes apply international rules differently to their public and private markets. A public market in this context defined as a stock exchanges and private market defined as a set of privately owned firms.[42] For example, from my original dataset, 82 countries require IFRS for firms on a stock exchange while only 23 countries require IFRS for firms not listed on stock exchanges.

[42] Governments also have various versions of IFRS and US GAAP for their budgets, but the politics of international agreements on government accounting standards are beyond the scope of this project. Unlike accounting standards for businesses, there are few resources for data collection on government accounting standards which makes it more difficult to study and the international political processes.

Additionally, these countries may permit IFRS use by any firm on the stock market (17 countries) or any private firm (60 countries) with some exceptions. Figure 3.3[43] has a summary of the different broad applications of IFRS within an economy to public and private markets.

Figure 3.3: International Coordination and Markets



How does coordination across countries form the patterns seen for markets and sectors in figures 3.2 and 3.3? To answer this, I briefly discuss why firms and markets are singled out in international agreements with a focus on the efficiency and distributional gains in crafting standards that leave out certain firms. In sum, I posit shared interests of firms and the opening

[43] This data shares the same source as figure 3.2. However, instead of looking at the individual industries, this data simply shows if an agreement included all firms (usually required by law), some firms (usually required by law), or if the agreement simply permitted the use of international standards. Public market here means any business listed on a stock exchange. Private market means any firms not publically owned.

of markets to foreign business drive international standards to be used or excluded by sections of an economy. I also use evidence from a joint report by the IASB and South Korean government to demonstrate that private regulators and government officials consider market and firm interests while negotiating with the IASB.

International Firm Coordination (Figure 3.2)

This coordination between countries stems from a variety of sources, but at the base level must involve some firm level or sector interest in using common rules. For example, firms exchanging goods, investing, and occasionally merging between countries will want similar rules for their valuations and financial statements. Without common standards, firms will incur extra costs translating statements and trying to adjudicate different valuations of items like profits and losses. Governments will also want their individual firms or sectors with the most international exposure to use standards that are efficient and familiar to foreign businesses since common standards reduce transaction costs.

For firms involved in finance,[44] using a common standard may help competitiveness as new developments in financial instruments and rules such as Basel II unfold. For example, the capital requirements of the Basel II accords did not require many changes in countries using IFRS because of the way IFRS had previously reported banks assets and liabilities. It is common new regulations within the G20 are similar to rules already used by IFRS countries. Thus, using a common standard like IFRS may help states keep their financial sectors in tune with the rest of

[44] Broadly, insurance and banking.

the world whereas using US GAAP or a domestic standard for banks may require more adjustments.

Many countries exclude banks from these rules. To put this in context, as stated 45 countries only use IFRS for their financial industries, but it is also the case that 15 countries specifically exclude financial firms from their agreements while applying IFRS to the rest of their economy. For the countries that specifically exclude banks in IFRS agreements, 80% have already modified IFRS rules (partial cooperation). This is likely a result of banks lobbying for exclusion because they do not believe modified rules would accurately represent their true financial value. French banks have frequently lobbied for exclusion since 2005, for example, citing valuation concerns. Additionally, it could also be a result of the banking industry trying to disclose less debts or problems on their balance sheets (see page 2 for an example of this). It is also possible financial firms have been specifically excluded because some states trust the IASB less given its modifications to IFRS banking rules at the request of the EU Commission during the 2008 financial crisis.

Small and medium sized businesses (SMEs) are sometimes excluded in IFRS agreements in states such as in Italy, Angola and Albania, but other countries agree to use IFRS for only SMEs (in particular those not on stock exchanges). In the 11 countries that use IFRS only for SMEs, it is likely the result of firm coordination between countries. For example, in Malaysia IFRS for SMEs were applied to all manufacturing since all of Malaysia's nearest neighbors use IFRS, yet small and medium sized property development firms were excluded. The exclusion of property development firms in Malaysia is likely because they have less international business

deals and no need to use common rules with property development firms in neighboring countries such as China.

Other countries such as South Korea,[45] Russia, and Fiji, require IFRS only for their state owned enterprises. This may be less of a coordination issue since the motivation for using IFRS in state businesses are different than for banking, SMEs, or extractive industries across countries. Instead of efficiency and ease of business with foreign firms, countries may require IFRS in the state owned sector alone for purposes of tax collection, fighting corruption, and procuring loans from international creditors. However, it is also possible that the state owned enterprises engage in businesses deals with firms from abroad and this makes transactions simpler for the state and more transparent for its partners.

International Market Coordination (Figure 3.3)

Countries using IFRS for sections of their market, which broadly encompasses all sectors, is a different type of coordination problem than with individual firms or sectors. Distributional consequences in standards agreements will be different for countries using IFRS on public markets than those using IFRS solely in private markets. Additionally, some countries may not require IFRS on either, but will coordinate with the IASB to permit (not require) some firms to use IFRS on their exchanges or for private firms to use IFRS independently. Every combination of required and permitted IFRS use exists in the data for public and private markets within countries.

[45] South Korea also requires it for their banking and insurance firms. Discussed in detail later.

In general, using a single standard on a public market, and not for private markets, may have a few advantages and there are distributional and efficiency reasons for countries to follow this type of coordination. For example, if a country's stock exchanges allow IFRS, they may attract foreign firms to list themselves that would have avoided doing so because of the different requirements of an unknown financial standard. New firms on stock exchanges bring in revenue for countries and facilitate access to credit and other financial services domestically. Also, coordinating with just public firms means the costs for transitioning to IFRS (or conceivably another international standard) are only borne by publically traded firms which arguably have the most to gain through transparency with international investors. Thus, the gains, costs, and efficiency are captured by the publically traded firms while not affecting private firms that may benefit substantially less or experience loses (due to transition costs).

For countries using IFRS for private firms, there are other distributional and efficiency consequences. Initially there are higher costs for smaller private firms transitioning to IFRS, but the advantage is it also prevents countries from developing two incompatible systems of financial standards (i.e. one for their publically traded companies and a different one for their private firms). Two separate and incompatible systems of standards have been an issue in several EU countries and others. For the small amount of private firms that have participate in international businesses transactions frequently, a common standard creates ease of business and investment. However, the majority of small and private businesses in most countries only operate domestically in terms of investment and acquisitions with other firms.

Moving along the frontier

I posit countries' regulators, which may be government or private, strategically open their public or private markets to different levels of international standards based on the market needs concerning access to credit and foreign investment. In this way, regulators are able to minimize costs to the country while maximizing benefits from transparency, efficiency, and investment between domestic and foreign firms. This should apply for countries agreeing to use IFRS for their public markets, private markets, and various selective sectors. Additionally, the selective use of international agreements will be independent of the cooperation issues that allowed countries to converge on a single standard.

For countries agreeing to use international standards for their public markets (firms traded on stock exchanges), access to credit and foreign economic exchanges should determine this type of coordination. Using IFRS agreements in this way allows countries to maximize benefits relative to costs, and smaller countries (economically) may be more prone to use this type of strategy. With new standards on public exchanges, smaller countries can potentially grow their international reputation as they slowly begin to build a stronger financial base in their larger cities (e.g. Hong Kong which uses IFRS for only public markets). Thus my fourth hypothesis:

> *H_4: Coordination strategy of using IFRS more on public markets will be greater in smaller countries building access to credit and financial bases.*

For private market international standards use (firms not listed on stock exchanges), I expect more developed countries with larger economies can absorb the costs of transitioning with less need to build a financial base (e.g. UK). Furthermore, more developed countries will be more likely to have private firms with more international business than less developed

countries. In this way, more developed countries will capture efficiency gains from transitioning its private market to international standards. Despite some EU countries creating two parallel systems of standards (one for the private market and one for the public), I expect on the aggregate other developed countries will want to only have one system of standards and avoid strategically selecting markets to apply international standards. Thus, my fifth hypothesis:

> H_5: *Coordination strategy of using IFRS more on private markets will be greater in developed countries with less need of building access to credit and financial bases.*

For sectors, I posit developing countries will be more likely to open only sectors to international standards and for the markets with the most international exposure and transactions. For example, Kazakhstan only uses IFRS for their extractive industries and this industry has the most[46] exposure to foreign investment. The government regulator deemed these industries to have "significant public interest" and agreeing to use IFRS for this sector may have made it more transparent domestically and internationally. Likewise, developing countries will want transparency for their banks since they are likely to have the most transactions with foreign creditors and transparency helps in procuring loans. Thus my sixth hypothesis:

> H_6: *Developing countries will be more likely to apply IFRS to sectors or firms with the most international exposure.*

In sum, coordination strategies among regulators and distributional consequences will be different for developed and developing countries in terms of markets (public and private) and how sectors or individual firms are treated. Countries building access to foreign credit will

[46] 33.2% of all foreign investment in Kazakhstan as of 2016. Found on Kazakhstan's government website (Invest Kazakhstan).

be more likely to use IFRS on their public markets. Developed countries will be more likely to use IFRS for their private markets since they can absorb the costs, and they will have less need to build credit access to foreign capital. Finally, regulators in developing countries will be more likely to apply IFRS to specific firms or sectors that have the most international exposure or foreign business deals.

Data and testing

Similar to the analyses in chapter 2, I use my original dataset of IFRS agreements around the world that is built through data collected from the Big Four accounting firms and the IASB. However, instead of focusing on the issues of rule bending or carve-outs (i.e. partial cooperation), the data in these analyses center on who uses the rules from an agreement. This encompasses countries' public markets, private markets, and sectors or firms for which data is available.

Dependent Variables

For public and private markets, I use an ordinal ranking system that captures how much a country has committed a market to IFRS. This mirrors how Deloitte, the largest global accounting firm, categorizes countries' use of IFRS in public markets, and I have extended the categorization to private markets as well. Table 3.1 captures the ranking system for public and private markets built on Deloitte's categories. This allows an ordinal logit regression with the IFRS use in a market as the dependent variable (for both public and private markets).

Table 3.1: Ordinal Ranking of Countries' Markets

No IFRS	0
Permitted	1
Some Required	2
All Required	3

For sectors or specific firm types (e.g. financial services), I use a dichotomous measure which is coded as a 1 if a country specifically includes it in an IFRS agreement or a 0 if it was not singled out. However, due to a low N and less variation among countries specifying sectors, there is less to glean from an ordinal logit analysis for sectors beyond banking and small businesses. Therefore, I complement my analyses with a small case study regarding the 2007 South Korean Agreement[47] between South Korean regulators and the IASCF (oversight committee of the IASB).

Independent Variables & Controls

For independent variables and controls, most are the same as chapter 2 except for independent variables measuring the access to foreign credit and market development and controls for regulator quality and rule of law. To measure access to foreign credit, I incorporate three measures of credit and market access from the World Bank's International Development Indicators dataset: (1) in constant 2010 US dollars the amount of foreign credit used by banks, (2) in constant 2010 US dollars the amount of domestic credit available, and (3) in constant US 2010 US dollars the overall foreign credit lent to the financial sector. The analyses below display

[47] As an example, here is a similar agreement (shortened) between China and the IASB: http://www.ifrs.org/Alerts/PressRelease/Documents/2015/2005%20Beijing%20Statement.pdf

results for the first variable of foreign credit variable above, and the analyses were similar for the other two. For market development, I use an ordinal measure by the world bank (1-8) with lower numbers indicating less market development and higher values signifying greater market development.

The controls for rule of law and regulatory quality are necessary to know if countries with greater ability to implement policy are the ones coordinating fully. The measures for these also come from the World Bank's development dataset. Regulatory quality is a measure of the perception of regulators in the country in areas like trade, but it does not consider how well financial standards are crafted. Rule of law is a measure of confidence in the quality of property rights, contract enforcement, police, and courts. For both measures, higher values represent better regulatory quality or better law-making on a scale from -2.5 to 2.5.

This data covers 119 countries with different connections to IFRS and is measured at a cross section since IFRS agreements rarely shift over time surrounding markets or sectors.[48] For purposes of robustness, I check the results at different periods in time: 2005, 2010, and 2015. One of the disadvantages of analyzing credit access and stock market growth is the data available for less developed or smaller countries is almost nonexistent until 2012. This means future analyses of this type may be more fruitful and it is also possible there will be more variation in countries selectively applying IFRS to sectors in the short term.

[48] In many ways they do, but the differences are very subtle. However, since IFRS is a relatively new phenomenon it is possible a lot more shifts will occur in the future.

International Market and Firm Coordination Results

Results from the ordinal logit analyses broadly support hypotheses four and five regarding IFRS coordination among countries and their market places. Table 3.2 shows greater market development and higher regulator quality are associated with increased levels of international coordination including requiring IFRS in public markets. On the other hand, more developed economies may be less inclined to fully required IFRS for their public sector and this likely a result of countries like the US, Japan, and Mexico that permit IFRS in some firms on public markets but have yet to require them for any or all firms listed. The relationship between development and IFRS on public markets (stemming from agreements) may be more like an upside down parabola which may have skewed the results slightly. Furthermore, manufacturing (non-financial firms) has no association with countries IFRS coordination for public markets nor does the level of democracy.

Because of multicollinearity between market development (as classified by the World Bank) and overall market size (in 2010 US dollars), it was not possible to use both variables in the same analysis. When analyzed separately, the results were in the same direction for the public market analysis and significant. The market development variable from the World Bank better captures market institutional changes than a simple measure of overall market size.

For private markets, the most important factor in greater levels of IFRS is the overall development of countries' markets (table 3.2). The World Bank ranks market development based on how well credit bureaus function along with other factors such as quality of financial service to firms and people. Smaller economies also tend to shield their private markets more

from international financial rules. Furthermore, the use of outside credit, unlike the public sector, has no association with coordination on the private market as expected from the hypothesis. However, market development, at a minimum, enables international financial standards for privately owned firms.

Table 3.2: International Coordination: Public and Private Markets

	Dependent variable:			
	Public Market		Private Firms	
	(1)	(2)	(3)	(4)
Market Development	0.138*	0.183**	0.240**	0.273**
	(0.079)	(0.077)	(0.078)	(0.076)
Regulator Quality	0.946**		0.557*	
	(0.386)		(0.321)	
Rule of Law		0.650*		0.182
		(0.338)		(0.281)
Foreign Creditors	-0.003	-0.002	-0.001	0.001
	(0.004)	(0.004)	(0.004)	(0.004)
GDP	-0.086	-0.087	-0.414**	-0.388**
	(0.140)	(0.140)	(0.128)	(0.128)
Polity	0.003	0.018	-0.058•	-0.042
	(0.037)	(0.036)	(0.036)	(0.035)
Manufacturing	0.002	0.003	-0.001	0.001
	(0.007)	(0.007)	(0.005)	(0.005)
FDI 2005	0.002	0.011	0.002	0.006
	(0.040)	(0.041)	(0.032)	(0.032)
Observations	119	119	119	119

The individual sector results are limited to financial institutions and small business due to a low N in other areas. The logit analysis of countries agreeing to use IFRS mainly for financial institutions reveals a relationship between foreign credit entering a country and agreements on international standards (table 3.3). With more foreign capital targeting the financial sector of a country, there is more likely to be IFRS use in that sector. Instead of broadly agreeing to use an international standard for the rest of the market (such as the entire public market), these countries may want to maximize investment efficiency by applying standards only to banking where it is most relevant. Since IFRS are still relatively new, it is possible many of these countries will agree to use IFRS in other sectors as they develop and experience more inflows of foreign funds.

For small businesses, less market development, poorer regulator quality, and rule of law seems to be related to small businesses' adoption of IFRS in these agreements. Though not directly addressed by the hypotheses, there are a few explanations for this relationship. First, these regulators may lack the expertise to determine how applying international rules to small businesses affects the domestic economy. Second, it may be the case that countries with less developed markets are selectively applying IFRS to small business with the intent of preparing themselves for growth and inflows of capital. As these smalls businesses develop, they will transition painlessly to public markets (where they can sell stock), whereas they would experience hardship if waiting to convert later. However, I believe poor regulator quality and not market foresight is the cause of this behavior.

Finally, why are the results from table 3.2 and table 3.3 so different? It is important to note that banks and small businesses in table 3.3 represent very small subsections of the public and private markets. Because of this, agreements targeting banks and small business are very specific and have different motives. The public and private market variables in 3.2 capture everything (e.g. retail, agriculture, manufacturing, mining, etc.). The decision in table 3.2 is simply what level of coordination in each market (e.g. permitted, required for some, all). However, the dependent variables in table 3.3 tend to capture a disproportionate amount of attention from regulators and government officials. In particular, banks and other financial institutions are the most divisive in terms of countries including or excluding from international reporting agreements.

Given the distributional consequences, efficiency gains, and firms' desire to use similar standards to their partners abroad, it is not surprising that countries only agree to use standards for sections of their economies. For public markets, countries using foreign capital would like to use international standards foreign firms are familiar with that allows harmony between its firms and new ones entering the market. These efficiency gains are also lobbied for by domestic firms to both private and government regulators (See Buthe & Mattli 2012). Finally, countries will only want to shift the cost of IFRS on sections of their markets that need it and more developed markets will be able to transition with greater ease.

Table 3.3: International Coordination: Banks and Small Business

	Dependent variable:			
	Banks		Small Business	
	(1)	(2)	(3)	(4)
Rule of Law	0.147		-0.763*	
	(0.356)		(0.410)	
Regulator Quality		0.304		-1.129**
		(0.400)		(0.476)
Market Development	0.041	0.023	-0.197**	-0.144*
	(0.085)	(0.089)	(0.092)	(0.094)
Foreign Credit Reliance	-0.015**	-0.016**	-0.002	-0.001
	(0.006)	(0.006)	(0.005)	(0.005)
GDP	0.355**	0.351**	0.400**	0.401**
	(0.159)	(0.158)	(0.174)	(0.177)
Polity	-0.030	-0.036	0.022	0.041
	(0.038)	(0.039)	(0.046)	(0.049)
Manufacturing	0.004	0.003	-0.005	-0.003
	(0.006)	(0.006)	(0.008)	(0.008)
FDI 2005	0.040	0.037	-0.005	0.004
	(0.041)	(0.041)	(0.053)	(0.053)
Observations	119	119	119	119

With large capital investment necessary for the growth of underdeveloped economies, it is not surprising countries are more likely to only open their financial sectors to IFRS when they are reliant on foreign capital (i.e. working with banks abroad or other official creditors). There are efficiency gains from seamless translation of financial statements and less costs to the rest of the economy that is less likely to be reliant on foreign capital. These countries are

getting the benefits of IFRS while minimizing the costs to their firms and the political costs of transitioning firms that are less likely to need IFRS.

The select use of IFRS stemming from the 2007 South Korea agreement is a major example of a country maximizing efficiency gains and moving along the Pareto frontier of one international standard. South Korea also uniquely uses IFRS for its public markets and selectively applies them to private banks but not the rest of the private sector. In a way, this behavior encompasses both the market coordination and the sector coordination issues discussed in this chapter and demonstrated in the results.

Results in the Context of the 2007 South Korean Agreement

Following the 1997 Asian financial crisis, South Korea sought to assure the world its financial sector was transparent and functioning like its western counterparts. To accomplish this, South Korea adopted US GAAP[49] for a short time. After a decade of use and the growth in popularity of IFRS, South Korea's private regulator in conjunction with 15 government agencies decided to move the country to IFRS to increase investment (Henderson 2015). This required several acts of legislation[50] and an agreement with the IASCF (i.e. the EU regulatory oversight committee). However, in this transition, the South Korean officials decided to apply IFRS to only publically traded firms and, in the private section of the market, only financial firms or banks.[51]

[49] At the time it was known as K-GAAP though there were no real differences beyond the name. This is a common naming practice when using US standards (or similar ones) such as J-GAAP in Japan.
[50] In particular, the Financial Investment Services and Capital Markets Act.
[51] Full list here: (including banks, insurance companies, financial holding companies, credit card companies, investment traders, investment brokers, collective investment business entities, and trust business entities).

Furthermore, officials recognized this would create two systems of standards within the country with some disadvantages for investment and ease of business.

Unlike the BAC and ASBJ in Japan (see chapter 2), the Korean Accounting Standards Board (KASB), in conjunction with the IASB, released a full report following their move to IFRS for public markets and private banks that makes clear their motivations. First, Korean officials believed the move away from US standards on their public markets to EU standards would strengthen the transparency of Korean firms, allow investors to make better decisions, and would burden businesses with extra costs to comply. The report also stated moving South Korea's public market to IFRS (as part of the agreement) was primarily due to South Korea's dependence on international business (i.e. foreign capital).

In making a case for treating the public and private markets separately, South Korean officials believed the public market was developed enough to absorb the costs and gain benefits while the private market lacked the development and would only incur costs associated with the move. They claimed the only sector in the private market with a strong demand for international standards was the financial industry (e.g. banks and insurance companies). These claims were based on the interactions regulators and government officials had with industry leaders when developing the roadmap and guidelines of how IFRS would be applied in any finalized agreement.

South Korea also took a unique step of applying IFRS to its quasi-governmental firms, and state owned firms. Similar to their banking sector, regulators and government officials decided to apply IFRS to government firms. This was done to help facilitate transparent

business practices with firms doing business with the government and for greater transparency with government finances. For transparency reasons, these types of firms are sometimes a priority for IFRS use in developing countries that are reliant on official creditors such as the World Bank.

Regarding the hypotheses and results from this chapter, South Korea's actions largely conform to the expectations. First, the motivations for opening the public market to international standards and not the private market stemmed from the different levels of market development in the two areas and the costs that would be incurred. This is in line with hypotheses four and five given South Korea needed foreign capital and business in its public market, and its regulators felt under development in its private firms would offset any possible gains (efficiency and investment). Second, it was determined IFRS would be useful for the financial sector in the private market due to demand within the finance firms in that sector. This is in line with hypothesis six since South Korean banks were concerned with access to foreign capital and, according to regulators, these banks had international exposure.

South Korea, unlike Japan, did not bend any of the rules of IFRS. It adopted them under an agreement with zero modifications, so South Korea's biggest issue was who would use the international standards in its economy. The country's regulators and government officials could position South Korea to gain the most from the international community while minimizing costs to firms with less international exposure. Thus, South Korea's standards issue was solely one of coordination with the international community with less motivation to bend the rules of the international agreement.

Finally, in its last report on IFRS progress, South Korean officials acknowledge that a single set of international standards may not be for every country, and there is a need for the IASB to become more flexible to accommodate newcomers. This may be indicative of South Korea regulators not finding as many benefits in strict IFRS use as with their domestic standard or US GAAP. The same report also stresses if the IASB allows too much flexibility in international IFRS agreements, it may "shake IFRS use to its core." This statement seemed to indicate caution in the path the IASB takes with developing countries, and may stem from a lack of trust in the EU regulator due to its unilateral changes after the 2008 financial crisis. Also, South Korea is no longer under international pressure for transparency as it was after its 1997 crisis that lead to US GAAP and then IFRS, so its regulators now may be evaluating the fairness of its new rules.

In the context of Cooperation and Compliance

Although South Korea did not make any cooperation deviations during the time it struggled with its roadmap to coordination, it allowed some deviation in the future from new IASB rules by installing an endorsement body (chapter 4 discusses this topic more thoroughly). Endorsement bodies, as briefly discussed in the last chapter and more so in chapter 4, have the ability to influence compliance with new IASB rules in the short-run. Exempting entire sectors or industries was something South Korea had a long-run interest in and codified into their IFRS adoption, but government regulators left the possibility of deviating from rules in the future with noncompliance.

Without the possibility of altering new rules through compliance decisions, South Korea may have carved out several rules and moved from full cooperation. However, South Korea

pursued a path of full cooperation given the scrutiny from its international accounting use during the Asian Financial Crisis. The exclusion of sectors may be easier to justify with the argument of costs or development, but the exclusion of larger IASB rules would likely cause South Korea to lose investments from the international community.

Coordination, like cooperation, tends to be sticky in the long-run and has yet to change in South Korea since the inception of IFRS in the country. Mechanisms to avoid compliance typically only work in the short-run[52] though, like Japan's regulators, government regulators in South Korea believed some kind of mechanism to control (i.e. manipulate) international compliance was necessary. Without its endorsement body (the body that decides compliance), South Korea would have likely made at least small cooperation carve-outs to protect itself in the future.

International Standards and Coordination

Agreement to a single international standard is not difficult for many countries, but deciding who uses the standard and whether a country can handle dual systems of standards is a complex political issue. As Buthe and Mattli (2012) discovered, firm lobbying drives regulator and government behavior for financial standards in the EU and US, and it seems this is also the case in places like South Korea for international agreements on standards. In this context, it is important to remember that independent of investment firms will want to use the same standards as their foreign counterparts. Additionally, independent of the politics there are

[52] The EU has stretched noncompliance for over a decade in some situations as I discuss in the next chapter, but this is not typical.

many reasons for using the same standard such as in other areas like the Web Protocols.[53] For IFRS, firms want the same standards for ease of business and efficiency, but regulators try to make agreements with international bodies that sometimes promote political interests and their domestic firms' interests.

Overall, the analyses seem to indicate the circumstances in which countries agree to use IFRS for parts of their economy are dependent on what is politically convenient and beneficial at the time. International agreements are more likely when a group within the country, such as banks, would like greater efficiency. These agreements are also more likely when a country needs to demonstrate greater transparency for a section of their markets to the international community for business or investment purposes. South Korea moved to US GAAP for this purposed and then to IFRS to please its business partners and its domestic banks (as well as foreign creditors). These agreements may be temporary and only out of convenience, but it is difficult to discern their longevity since few countries have moved completely away from IFRS.

Furthermore, the results lend support to Perry and Nolke (2006) since they support their assertion that international accounting tends to shift away from the productive sectors of the economy (i.e. the manufacturing sector). None of the results in the analyses found the manufacturing sector to induce international standards coordination. Besides unique cases like Kazakhstan, countries appear to determine their standards needs based on their financial sector and need for access to foreign credit. South Korea's emphasis on banking and the large amount of IFRS only banking agreements seem to support Perry and Nolke's analyses as well.

[53] Despite having more in common with standards from the Basel Accords or other financial agreements, the IASB frequently compares its standards with those used to facilitate the international use of the internet.

The literature on the politics of IFRS has missed the nuances of its application stemming from countries' agreements with the IASB. It is clear from this chapter's analyses that not all agreements for IFRS lead to the same point on the Pareto frontier since countries are mainly using it for those that benefit the most. Therefore, analyses of international standards and their agreements should consider how rules like IFRS are applied in addition to how governments negotiate them with private regulators.

The literature has also missed the distributional consequences of multiple types of international standards agreements. For example, if Kazakhstan uses IFRS only for its extractive industries, it may gain ease of business with its foreign partners, but it also will not pay the transition costs for other types of firms. Thus, stronger industries will be more likely to use international standard while weaker firms are protected from international agreements. These distributional consequences, which are currently allowed, may lead to the disintegration of standards like IFRS

Like partial cooperation, there are inherent dangers of the IASB allowing countries to use international standards for selective parts of their economies. First, since IFRS is still relatively new as a standard compared to US GAAP or others, it is unclear if countries will grow to favor a different standard in the future or switch back to US standards. Second, it is unclear how countries will maintain dual systems of standards for their private and public markets or different sectors and if they will come to favor their domestic standards over IFRS as IFRS changes in the future. Third, it is unclear how countries will manage their agreements with the IASB if these sectors no longer benefit from IFRS or if firms' foreign business partners switch to a different standard.

Unlike the problems presented by countries bending rules, these coordination problems will not create different IFRS that are no longer compatible. Instead, the danger is in IFRS no longer being used anywhere or so few countries will use them in the same sectors that an international standard will be meaningless. For example, there is no benefit for South Korea to use IFRS for banking if very few countries use them for banking. Organizations like the IASB could mitigate this danger if IFRS had to be phased in slowly to an economy. The requirement of a slow adoption process would stop dual systems of standards from developing and make business transactions across countries easier in the long run. However, countries like the US have been working on slowly phasing in IFRS for the last 17 years with little progress.

It is difficult to discern which countries are gaining the most from the current coordination problems with IFRS agreements. In the long run, it may be countries using IFRS for all sectors and avoiding the dual system problem will be winning; however, IFRS is like Esperanto in the sense that if no one uses it, there are no real benefits to using it. In the short term, countries that maintain a separate domestic standard may be at an advantage if IFRS starts to fragment in the future. At the same time, these countries have avoided incurring costs to their smaller firms that do less international business.

In sum, much like the problems with partial cooperation and rule carve-outs, selective application of international standards has the ability to make them meaningless. The findings in this chapter complement previous literature on the politics of IFRS by examining how the agreements actually work, and the political considerations of countries in the process of using IFRS. Furthermore, by examining the different ways in which countries can selectively use IFRS, I

added a more nuance analysis of international agreements between private regulators and how governments sanction them.

Chapter 4

Endorsement and International Compliance[54]

"Many jurisdictions do not accept our Standards blindly, but have an endorsement mechanism in place. They know that non-endorsement is rather like an atomic weapon, inasmuch as you would rather not use it. Still, they rightly believe it is an effective mechanism to make their voices heard in the standard-setting procedures of the IASB."

- Hans Hoogervorst, President of the IASB (EU Regulator) speaking about compliance, 2015

"If you have understood this standard, you haven't read it!"

-Sir David Tweddie, Executive Chairman of the IASB, 2009

After announced rule carve-outs (i.e. partial cooperation) and selective sector use (i.e. partial coordination), government or private endorsement bodies[55] are tasked with ensuring future compliance. The purpose of endorsement bodies is to delay, interpret, and sometimes deny new international rules as they are introduced by the IASB (EU regulator). Typically, the two tools these endorsement bodies have for noncompliance are: (1) delayed implementation, and (2) differing interpretations of rules. These bodies always develop after (and only after)

[54] Accounting bodies and endorsement change quickly in the world. With that in mind, some of this section may not be accurate past 2015. I ask readers to understand that, and know I tried my best to represent these procedures to a general audience with limited knowledge of accounting.

[55] These endorsement bodies are almost always the private standard setter within a country. However, a private standard setter (e.g. IASB, FASB) may exist independently from the endorser. Within this chapter I tend to use private regulator and endorsement body interchangeably.

initial international agreements are solidified (i.e. after cooperation and coordination problems I have outlined in the previous chapters).

Noncompliance tends to be a short-term solution to countries experiencing problems with their international regulatory agreement while rule carve-outs (i.e. partial cooperation) and coordination tend to be long term. Because anticipated compliance may mitigate some of the issues of cooperation and coordination, private regulator independence and their incentives to distort international standards shape cooperation and coordination to an extent. Issues arise when compliance bodies are subject to politically appointments or lack financial independence from government bodies.

Noncompliance (via endorsement bodies) is another way in which countries cheat or renege on their international accounting agreements. Specifically, noncompliance is useful for broad financial stability in direct opposition of the goal of transparency held by most private regulatory bodies. Instead of removing a rule formally (i.e. partial cooperation), endorsement bodies simply choose to ignore the rule or reinterpret it differently. This, like partial cooperation, obscures financial transparency to so firms may report more attractive financial statements (i.e. not reporting bad debts or anything else affecting financial health).

Outside of the EU, most endorsement bodies are typically also a country's private regulator (though sometimes a separate private entity) that previously set domestic standards. Problems develop with compliance when the heads of these organizations are political appointments or the organizations suffer from threats of funding if beneficial compliance decisions are not made.

Besides shaping international cooperation and coordination outcomes to an extent, compliance with regulatory agreements changes the Pareto frontier and international confidence.[56] Without proper compliance, these agreements are suboptimal and less effective in regulating international capital flows and providing cross border investment information (see Figure 4.2). Furthermore, unlike the issues for cooperation and coordination, the problems with private bodies ensuring compliance are more opaque[57] and difficult for investors and international actors to discern.

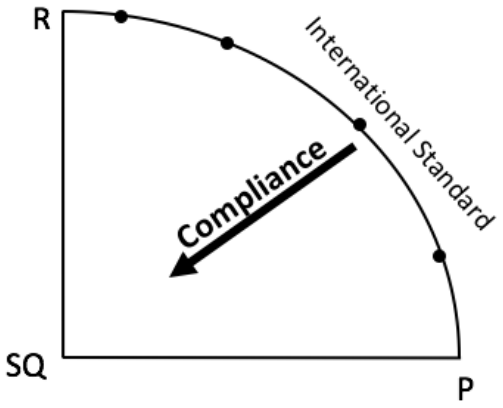
There are three main issues that push countries toward noncompliance: (1) political independence of private regulators (i.e. endorsement bodies), (2) financial independence of private regulators, and (3) the disconnect between the regulatory goals of private and government bodies. Moreover, the first and second problem are compounded when countries undergo external shocks, such as financial crises, because regulators have perverse incentives to manipulate compliance requirements for the benefit of the economy or specific firms. The third problem can be the result of several factors for government and private regulators such as (1) capabilities, (2) expertise, or (3) a lack of communication between agencies.

Answering the question of how standards compliance may fail complements research on international regulatory outcomes and sheds light on potential political issues with similar regulatory agreements (e.g. Basil Accords). For example, Drezner's (2007) argument that regulatory status quo is the goal of regulatory agreements does not consider how private

[56] I mean both international investor confidence and the confidence that governments and partner organizations have in the country that reinterprets rules to its advantage.
[57] The opaqueness is largely a function of the information available on compliance which is incredibly rare.

bodies are necessary for compliance and their procedures (such as endorsement I discuss later in this chapter). Additionally, the emphasis on private regulators, rather than government ones, also complements research surrounding international standards' growth and use (Abbot & Snidal 2001; Buthe & Mattli 2007; Simmons 2001). Finally, it augments work of Alt et. al (2014) that demonstrate noncompliance with IFRS (or other financial standards) increases during election cycles.

Figure 4.1: Moving away from the Pareto frontier



Roadblocks to International Regulatory Compliance

A lack of political independence interferes with regulatory compliance and is similar to the issues central banks experience with monetary policy. Unlike central banks, the dilemmas surrounding the political independence of private regulators are not well understood. This may stem from a lack of data about international regulatory agreements, or because these

regulatory outcomes do not affect the economy as much as central banks. Additionally, the endorsement process, which is how many private regulators manipulate compliance, has also been understudied. My original dataset, for instance, has the only complete listing of regulators that use endorsement for international compliance purposes.

Private regulators can be classified as politically independent when they are free from approval from a government body and their leadership is independently appointed. For example, Brazil's private regulatory body, the Brazilian Accounting Pronouncements Committee (CPC),[58] is politically dependent because its head is appointed by the Brazilian president and must also answer to the Central Bank of Brazil. The responsibility for compliance can sometimes be a government regulator duty though this is less frequent. France, for example, exclusively uses its governmental body to ensure compliance (Autorité des Marchés Financiers). On the other hand, Britain allows its private regulator, the Financial Reporting Review Panel (FRRP), to take firms to court over non-compliance.

This lack of independence creates perverse incentives for how private regulators interpret new rules or if they pass regulations through their endorsement process. These incentives can include increased (or continued) government funding and support for the endorsement body. This ultimately leads to selectively compliant endorsement bodies. Table 4.1 lists which countries use endorsement bodies or require additional government input before standards boards approve new rules.

[58] In Brazil known as O Comitê de Pronunciamentos Contábeis

Table 4.1: Cooperation, Coordination, and Compliance within the G20[59]

Country	Partial Cooperation	Partial Coordination	Endorsement Process	Additional Government Compliance Guidance
Argentina	No	No	Yes	No
Australia	Yes	Yes	Yes	Yes
Brazil	Yes	Yes	Yes	Yes
Canada	No	Yes	No	No
China	Yes	Yes	Yes	No
European Union	Yes	Yes	Yes	No
France	Yes	Yes	Yes	Yes
Germany	Yes	Yes	Yes	Yes
India	Yes	No	Yes	Yes
Indonesia	No	No	No	No
Italy	Yes	Yes	Yes	Yes
Japan	Yes	No	Yes	No
Korea (South)	No	Yes	No	No
Mexico	No	No	No	No
Russia	No	Yes	Yes	No
Saudi Arabia	No	No	No	No
South Africa	No	Yes	No	Yes
Turkey	Yes	Yes	No	No
United Kingdom	Yes	Yes	Yes	No
United States	No	No	No	No

[59] This table is similar to table 1.1 but it contains an additional column detailing when additional government guidance on compliance is required within a country. The data is from Deloitte (current as of 2015) using my definitions of partial cooperation and coordination. Additional government compliance means in addition to the endorsement process there is a second government body that also reviews standards and issues guidance on how standards should be applied (after the first round of endorsement). Since the US agreement has yet to be finalized, the information here is somewhat different than the information about the US in the case study section.

Preventing International Compliance with Endorsement Bodies

Regulatory compliance can be viewed as a two-part political process. First, when new rules are developed and dictated by the IASB (EU Regulator), there may be pressure to alter the interpretation and date of implementation. This first process is usually determined by endorsement committees (typically a country's private regulator) and is an extremely common tactic for noncompliance. Second, if a regulator does not explicitly state noncompliance in the endorsement process, they may do so by ignoring noncompliant practices within the country. This means they may overlook noncompliant firm practices because they never intended to comply with the rule, or as a means of temporarily helping firms that are in financial trouble.

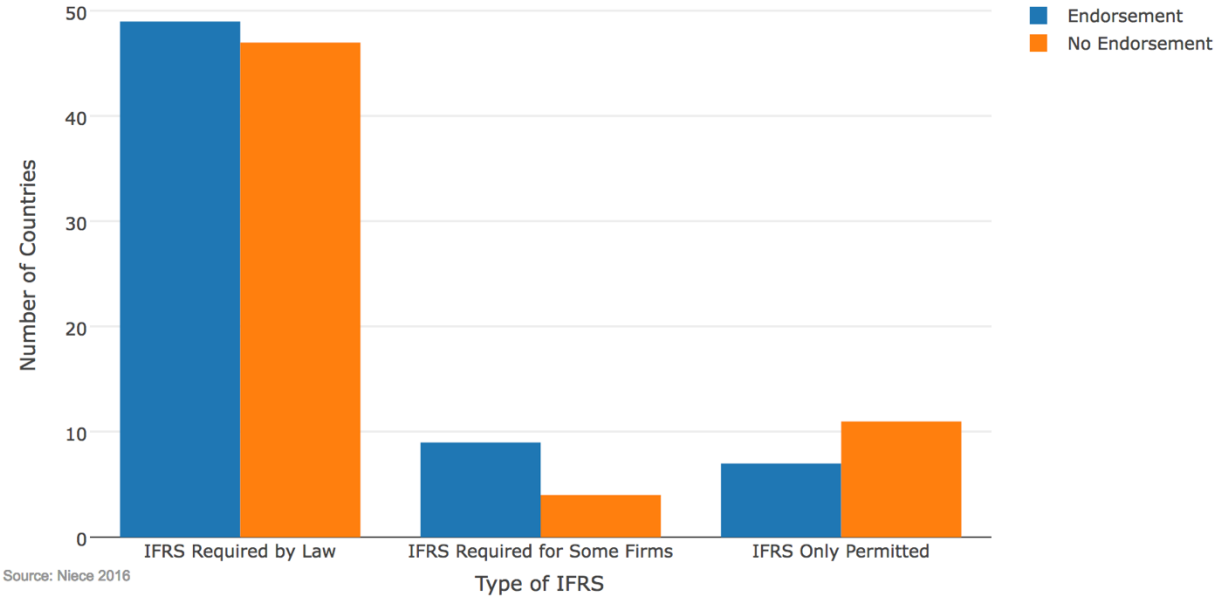
While partial cooperation (conceptualized as formal rule carve outs) tends to be static and carved out before an agreement, compliance is dynamic and changing with the needs of firms and the economy after the agreement. To be clear, partial cooperation tends to occur when countries carve-out large rules within IFRS after an agreement via legislation (or other channels). Compliance is a question of how well countries adhere to the constantly changing rules (i.e. rule updates) from the IASB (EU regulator) and how well countries' endorsement agencies ensure[60] firms follow rules.

Unlike international law or other agreements, regulatory standards such as IFRS are dynamic and sometimes unpredictable. Even if the initial standards match a country's preferences or conform to a country's regulatory status quo (i.e. Drezner's theory of international regulatory agreements), the rules may move to a different preference point years after. To protect themselves against this, more than half of all countries (See Figure 4.2) use an

[60] For instance, they may recommend fines for failing to comply with new rules.

endorsement process to approve any changes dictated by the IASB (EU regulator). In most countries, a private regulatory body is exclusively responsible for endorsement except in the EU, which uses the EU Commission[61] (i.e. a government body to police its private regulator).

Figure 4.2: Countries Using Endorsement to Block Compliance



The countries in figure 4.2[62] that forego endorsement may still not fully comply with IFRS, but they have no mechanism for rejecting new rules or interpreting them in a noncompliant way. Countries without endorsement may fail to comply due to a lack of

[61] This process is complex within the EU Commission. There are several committees and other bodies that review these. I describe this more in the EU Case study in this chapter.

[62] The primary source of the data is the IASB's 2015 World Report. This report describes in detail the different mechanisms countries use for endorsement when agreeing to use IFRS. However, there are some gaps in this data and those gaps are filled through Deloite's IASBplus online archive that speaks to endorsement procedures in more countries. This data is current as of 2015 and will change in the future. Furthermore, IFRS only permitted describes countries that legally permit but do not require by law IFRS. Required by some firms describes countries that legally require IFRS for some sectors of their economy.

resources or a lack of expertise and understanding of the implications of new rules issued by the IASB. This type of non-compliance is typically not intentional whereas the endorsement mechanism can be used for rule specific non-compliance.

As stated previously, the two tools endorsers have for noncompliance with IFRS are: (1) delayed implementation, and (2) differing interpretations of new rules. The first, which is employed in the EU frequently, is to delay new rules for years at a time. When new rules are delayed[63] in one country but not the others, the comparability of cross border investments is sometimes lost. This can occasionally be done under the guise of "researching the impact of new standards" or to delay any detrimental economic consequences from new standards until conditions are better. For example, some new rules were delayed for Greece during the EU financial crisis, and, as an extreme example, Venezuela has not endorsed any new rules or modifications since 2003. Other countries' private endorsers typically delay rules by a year at the most, but can delay rules indefinitely if they choose.

The second endorser tool is to interpret new rules in a different way from their original intent. For example, if the IASB dictates a new way in which banks must value an asset, the endorser may choose to interpret or codify the rule in a way that is inconsistent with the IASB's intent. For example, in 2004, the EU Commission interpreted rules for hedge accounting with European banks differently by ignoring a paragraph of a new standard. Jordan's endorsement committee, on the other hand, decided in 2007 to interpret rules for property valuations differently "temporarily" until market concerns had eased.[64]

[63] The literature tends to refer to this as being "out of sync."
[64] This "temporary" interpretation is still ongoing as of 2017.

Overlooking Firm Noncompliance

Normally, if a regulator has an issue with compliance, it files a request to discuss the problem with the IFRS interpretations committee (IFRIC), but sometimes regulators choose to ignore a rule instead. Ignoring a rule may mean asking other enforcement agencies to forego fines those in violation or issuing guidance on a rule stating it is not necessary. For example, Brazil's private regulatory body, which has its leadership appointed by the Brazilian President, rarely asks for compliance on a plethora of standards. By one estimate (Santos 2010), over 55% of Brazilian firms were in noncompliance with international standards. While some of this noncompliance was due to the CPC (Brazilian regulator) interpreting new rules differently, the CPC also choose to ignore several new rules (Santos 2010). Since the IASB has no mechanism for punishing countries that fail to implement new rules, the CPC can endorse all rules, claim to follow those rules, and then ignore the new rules it endorses.

Perverse Incentives and the Political Cost Theory of Accounting

At the endorsement stage for amending IFRS rules, regulators (i.e. endorsers) must consider several questions before they accept a new rule. For instance, regulators in the EU must ask the following questions:[65]

1. Is the rule favorable to the "public good" in Europe?
2. Is the rule consistent with the "true and fair" view required by the EU?
3. Does this rule create the financial transparency to make economic decisions?

[65] These questions are from the influential Maysadt Report.

These compliance questions are not concerned about compatibility with other countries (i.e. the purpose of international standards). Instead, regulatory compliance is a question of national interest[66] or what is beneficial to the country or jurisdiction. In the EU, regulators depend on the same governments for funding that also demand rules are "favorable to the public good in Europe." This creates perverse incentives for noncompliance and is compounded when leaders of regulatory bodies are appointed by government officials (e.g. Brazil's CPC).

Why choose noncompliance if cooperation and coordination have already been decided? Countries could choose a level of cooperation, the firms to use those standards, and simply comply with those rules and their future iterations. In a sense, compliance should be less of a problem because so many international standards are already carved=out or removed from sections of a country's economy.

I posit purposeful noncompliance at this stage is directly related to the loss of independence by regulators (political independence) and the complete divergence of goals between governments and investors. If and only if the regulator's independence is compromised, then can governments persuade them to choose noncompliance over complete transparency and international comparability. The core argument of this chapter concerning deviations in compliance is simply: Governments wish for financial stability while investors wish for transparency, but governments are more likely to manipulate politically dependent regulators. The implicit hypothesis of this chapter I demonstrate in the case study section is:

H_7: In difficult economic times, governments will pursue noncompliance via pressuring politically dependent regulators to ensure financial stability. This is at odds with the regulators' purpose of ensuring financial transparency.

[66] I was reluctant to use this phrase here as it can be defined as almost anything. However, I broadly mean economic advantage.

Within the history of standards, the pressures for noncompliance have stemmed from two events. First, noncompliance can be a short term and temporary response to economic shocks. Second, private regulators, such as the CPC with politically appointed leaders, may use massive low-level noncompliance to discretely mitigate their commitments to international agreements. This is also aided by the fact low-level noncompliance can be difficult to detect and requires well-funded independent studies since the IASB (or other international agencies) currently leave compliance strictly to national regulators.

A Brief Note on Small Issues of Noncompliance

For the purposes of this project and other related research, it is impossible to prove, without enormous funding, that regulators are pressured into mass low-level (i.e. ignoring small and mostly insignificant deviations from rules) noncompliance during normal economic times. To produce the necessary data, it would require hundreds of experts, surveying hundreds of firms, and interviews with government officials and regulators. However, I believe it is necessary to acknowledge it as a possible reason and mechanism for noncompliance with international regulatory standards.

Part of the difficulty in assessing the magnitude of low-level noncompliance is, unlike cooperation and coordination, there are usually no official declarations. For example, since the CPC in Brazil would not share its compliance data, an independent team of auditors used the accepted financial statements of 310 firms in Brazil to determine compliance rates. Regulators may also interpret a new rule in a different way than intended while petitioning IFRIC (IASB

interpretations committee). This allows over a year of noncompliance with less reputation costs given the regulator can claim it is trying to adjudicate their differing interpretations.

Large Scale Noncompliance as a Temporary Solution

As I demonstrate in the case study section, for financial regulations, such as IFRS, noncompliance can be a temporary response to economic shocks and financial instability. This is different than the partial cooperation that I posit occurs during crises in chapter 2. Partial cooperation during crises involves legislating entirely new rules or developing a second set of parallel standards. This short-term sets of rules or parallel rule development in crises is beyond the scope of this project.

Non-compliance during crises, on the other hand, stems from delaying implementation of rules for additional years or accepting the rules but ignoring them on a massive nation-wide scale. During the EU debt crisis, countries such as France and Greece asked their regulatory bodies to ignore new rules for 6 to 7 years and to use previous IFRS rules in the meantime. Complying with new IFRS rules meant some additional reporting which many, like Sarkozy,[67] believed would hurt the investment prospects on the aggregate for these countries.

Countries like Australia and New Zealand with independent regulators are inherently better positioned to comply with international regulation during crises than those with politically dependent regulatory bodies. In fact, the highest level compliance countries from

[67] Here, I'm specifically referring to when Sarkozy asked that mark to market accounting rules should be ignored for some time in 2008. However, Sarkozy was and remains an opponent of harmonizing accounting standards from a cooperation, coordination, and compliance standpoint.

figure 1.5 (Hungary, New Zealand, UK, and Ireland) have independent regulatory bodies to ensure compliance. Thus, while the quantitative data is insufficient to draw wide-reaching conclusions, independence may hinder large scale noncompliance during crises and low level regulatory noncompliance (i.e. the smaller rules that are not enforced during normal economic times).

Political Cost Theory of Accounting

Since the late 1970s, finance literature has recognized there is a relationship between political goals and regulatory compliance in the "political cost" theory (Watts & Zimmerman 1979). This theory posits that compliance with regulatory rules (i.e. the country's private regulator) is largely a function of how compliance impacts the economy (i.e. government revenue) and regulators are wary of this when making compliance decisions. With a negative economic shock, politicians would have an incentive to direct regulatory bodies to overlook noncompliance if it would cause firms harm to comply or impact tax revenue. Most literature examines this in terms of domestic tax policy and overlooks how political cost may influence international compliance. However, the core tenant of political cost theory, that compliance is driven by economic concerns, fits well with my theory that regulators are noncompliant during challenging economic times.

Finally, from a policy point of view, the problem with noncompliance during an economic shock is the enormous long term harm it may cause. With instability, investors and official creditors need transparency to allocate capital efficiently. In the short run, investors may be misled by noncompliance and in the long run the economy will suffer. Fortunately, the

cases of extreme noncompliance have only occurred in the largest crises and from private regulators that lack independence.

A Brief Note on International Compliance Data

Briefly, all data in the following section, unless otherwise noted, comes from the agency or endorsement board located within the country of question. This covers standards boards and (when separate from the standards board) endorsement agencies. All this information is publically available (e.g. tens of thousands of pages of word for word transcripts of meetings between agencies such as the IASB and FASB can be found online). Thus, it is typically easy to discern the large noncompliance decisions by these agencies.

Given the limited nature of international compliance data, I choose to examine the EU at a broad level, Greece as an extension of the EU analysis, the US, New Zealand, and Canada. These countries have the most transparent data available concerning compliance and their agencies responsible for standards and (sometimes a separate agency) endorsement. I focus on the time period after the 2008 global financial crisis.

I recognize these countries were not all impacted the same from the 2008 crisis. However, even when EU compliance decisions negatively impacted New Zealand and Canada, these countries continued with strict adherence to their international agreements. Additionally, because countries like Canada and New Zealand complied without incident, there is less to say about these countries' actions, but I do report how their agencies helped promote international compliance.

Finally, since finance literature recognized compliance decisions as political as early as the 1970s with the political cost theory of accounting, there is less of a need to establish the process is politicized. Additionally, political scientist such as Art et al 2014 have discussed how IFRS noncompliance increases during elections. Thus, the goal in the following section is to demonstrate boards that are politically dependent[68] are more prone to push for stability over transparency in the short run (though in the long run these are likely related).

Compliance in the EU, Greece, US, New Zealand, and Canada

In a 2011 letter to the European Securities and Markets Authority (ESMA) regarding Greece's noncompliance, Hans Hoogervorst, president of the IASB, stated "We are aware that, as an accounting standard-setter, the IASB does not have the authority to ensure compliance with International Financial Reporting Standards." In this brief section that follows this small introduction, I discuss some of the reasons Hoogervorst expressed concerns about the EU and Greece to the ESMA. In part, his letter was in response to several actions taken by the EU Commission to change the IASB and mitigate its rules for countries such as Greece.

Within the EU and Greece, the road to noncompliance with international regulatory agreements began before the EU's legal adoption of IFRS in 2003 (Council Regulation 1606). The initial regulatory law passed in the EU, in addition to carving out some rules (i.e. partial

[68] Standards boards or endorsement agencies that have a leader appointed by a government official or have their decisions tied to a vote from another political institution. This may also take the form of a government funding the agency and threatening those funds. These three ways to political dependence may not all yield the same result, but in this section I try to demonstrate how they have. The results may be different in other countries however there is limited compliance data globally.

cooperation) also accepted, but delayed, other rules for years. The regulatory law set the conditions for noncompliance such as rejecting future rules (through non endorsement) that the EU perceived as hurtful to its economy.

Shortly after, Greece, like other countries in the EU in 2005, had a level of compliance that was similar to the rest of the world or better at 80%[69] (Tsalavoutas 2009). Following the 2008 crisis, this level dipped as low as 50% and by 2014 was still one of the lowest rates[70] in the world. These low international compliance rates occurred with unprecedented delays in implementing new international rules. Greece's compliance problem was only possible[71] because of a lack political independence in its rulemaking bodies and those that ensure compliance such as the Hellenic Accounting and Auditing Standards Oversight Board (HAASOB).

Greek legislation also interfered with compliance by allowing firms to apply rules differently (Ballas et. al 2015). Additionally, EU regulatory bodies and the Greek Government used noncompliance with the goal of helping the Greek economy and Greece's credit rating (Gebhardt 2016). Before the efforts of the EU and Greek Law makers, the IASB rules dictated

[69] The standard deviation was about 7%.

[70] Out of the countries with data. It's possible Greece may be relatively more compliant than most of the world, but it is difficult to discern given compliance rate data only exists for 30 or so countries.

[71] In terms of the counterfactual here, the EU is a really bazaar place for compliance because supranational bodies and country level bodies are responsible for compliance. However, unequivocally, at the supranational level much of Greece's noncompliance stemmed directly from the EU Commission. Within the EU Commission talks, as documented by Zeff and Camferman 2015, the EU Commission only made noncompliance changes after clearing them with other countries both within the EU and outside of the EU. It is unlikely Greece could have accomplished this by itself. For example, German officials had to be consulted when the value of Greek debts within their banks were downgraded (via noncompliance).

Greek banks had to report at least 50% of their losses. However, through noncompliance some firms reported only 21% losses on their debts.[72]

Within Greece and the EU noncompliance was achieved mainly by delayed implementation of several IFRS rules and the reinterpretation of rules. This was done both at a national level by private bodies in Greece at the request of government officials and at the supranational level within the EU (e.g. the EU Commission). It also impacted enforcement by supranational entities such as the ESMA and national entities such as the Hellenic Capital Market Commission (HCMC) in Greece.

The EU's Reinterpretation of IAS 39 and IFRS 7

Alone, Greece's issues did not motivate the EU to move toward noncompliance. Greece is only one small part of the EU's noncompliance story. The EU's history of noncompliance began shortly after its legal adoption of IFRS and in the face of several rule carve-outs (partial cooperation) and firm exemptions (partial coordination). To protect itself from future rule changes with the IASB, the EU Commission[73] was given the power of endorsement that allowed it: to delay new rules, reinterpret current and new rules, and block new rules. Endorsement bodies are common in conjunction with a private standard setter, but the EU Commission is unique in this task because it represents an enormous market, it funds the IASB, and it is responsible for more than one country.

[72] Specifically, Greek government debt.
[73] As of 2017, this power still broadly rests with the EU Commission, but there are several government bodies within the EU battling to be the endorsement body.

Immediately after the legal adoption of IFRS, the EU Commission decided to keep IAS 39, a rule concerned with financial derivatives (futures, options, etc.), but to interpret it differently.[74] This 2004 reinterpretation failed to comply with the goals of IAS 39 as issued by the IASB (EU regulator). It was a case of stability[75] over transparency. In light of these changes, Dimitris Chorafas, an IFRS expert, noted:

> "If many companies and some heads of EU governments are uncomfortable with the way IAS 39 makes hedges transparent, it is because they have things to keep out of public view. By correctly obliging them to show the value of instruments they use (i.e. bonds), IFRS renders every stakeholder a great service…If you let a company [or government] choose its accounting system, it can prove anything it likes."

The overall impact of the reinterpretation was small within the EU economy compared to the 2008 reinterpretation. The 2008 reinterpretation allowed EU banks to report losses on bonds from governments (such as Greece) as a fraction of what the costs were valued at under the previous interpretation. The impetus for this reinterpretation was a perceived advantage US banks had over their EU counterparts at the start of the financial crisis.

This perceived fear drove Sarkozy and finance ministers at a 2008 European and Financial Affairs Council (ECOFIN) to demand immediate changes by the IASB. These changes were on top of the rule interpretation changes already implemented by the EU Commission. At

[74] The EU Commission stated "in particular, the amended standard is not contrary to the principal of providing a "true and fair view" of a company and is conducive to the European public good. Whereas the fair value option under the original standard was unrestricted…" The Implication here was the old standard, before the EU Commission changed the interpretation, was not good for the EU public good.

[75] Sarkozy made the comment about stability in a 2004 speech as Minister of Finance.

the same time, the ESMA at the EU commissions' request, stopped punishing firms and banks within the EU that underreported losses from government bonds (Gebhardt 2016).

In the lead up to reinterpretations in 2008, meetings between the EU Commission and the IASB were very tense (Camfferman & Zeff 2015). As Sarkozy and EU finance ministers threatened to use legislation to reinterpret rules if the IASB did not, the IASB executive chairman, David Tweedie, communicated with the SEC on possible changes to IFRS. The IASB wanted the US to fully cooperate (in the future at a minimum) and was fearful too much change would stop the US process of adoption. The SEC warned large carve-outs to IAS 39 and IFRS 7, which would both make banking debt less significant in the EU, would harm any future US involvement in IFRS.

Despite warnings from the David Tweedie, the pressure was too great from Britain, France, ECOFIN, and the EU Commission. In October of 2008, the IASB had perverse incentives to regulate differently, and the board's membership was fearful of losing the EU market entirely. Finally, the IASB reinterpreted IFRS 7 and IAS 39. However, these changes were not everything the EU Commission and Parliament and EU Commission demanded.

At a press conference later in October 2008, Sarkozy stated the handicap hurting EU firms had finally been removed, and thanked Gordon Brown (the then UK Prime Minister) for his support. This "handicap" removed meant less transparency in banking debts for greater stability in the EU. Following the threats of noncompliance, the EU Commission took several steps of direct noncompliance.

EU: Delay, Threatening Funds, and Failure to Enforce

Beyond the reinterpretation of international rules, the EU Commission took three actions to skirt compliance and to create seemingly better financial reports from EU countries (with a focus on Greece): (1) the delay of new rules by almost a decade, (2) the threatening of withdrawing funds from private regulators, and (3) directing enforcement agencies to overlook noncompliance. The delay of new rules occurred almost immediately after the financial crisis (until 2018) as did the lack of enforcement by bodies such as the ESMA. However, it was not until a year after the crisis that the EU Parliament threatened the IASB's funding.

To correct issues of noncompliance, the IASB proposed to the EU Commission[76] a new rule that they believed the EU and other countries could comply with it: International Accounting Rule 9 (IAS 9). Despite its proposal immediately after the financial crisis and the EU Commission's statement that all rules should be endorsed within 8-12 months, the EU Commission stopped the IASB from passing the rule until November 2016. Furthermore, this rule will not be legally required for firms within the EU until 2018 (some firms will have until 2020 though). Thus, the EU Commission was able to delay compliance with a rule for almost ten years.

Why was the delay of IAS 9 so important? IAS 9's purpose was to replace a previous rule (IAS 39) that the EU Commission continuously reinterpreted[77] in ways that was advantageous to EU firms. With IAS 9, the EU Commission's noncompliance would be even greater than before,

[76] Technically all rules are examined by the EU parliament and Council first, but the EU Commission has the final say. As noted elsewhere in this dissertation, the EU parliament is currently fighting for the EU Commission's power to approve or deny new rules and the power of interpretation.

[77] This is in reference to using vague definitions in IAS 39, in ways not intended, to hide debt.

and vague language, which the EU used to skirt compliance, was eliminated in IAS 9. Delaying the rule by 10 years allowed the EU to weather its financial crisis in its own way. Furthermore, it avoided the reputation costs of promoting IFRS to other countries (usually via the IMF) while in a state of greater noncompliance (as would have been the case with IAS 9).

Political and financial dependence of standard setters can also be used to further noncompliance with international regulatory agreements. In 2010[78] the EU Commission threatened to withhold funds (£7.9 million) from the IASB when discussions broke down regarding compliance with IASB 39 and the development of IASB 9. In addition to potentially withholding funds, the EU Parliament stated it would review its funding of the IASB on an annual basis. At the time, Hans Hoogervorst called the move "a threat to our independence" and "totally unacceptable". This was followed by several additional moves to withhold funding from the IASB in order to tailor rules around the EU's needs. For example, in 2014 the EU parliament agreed to funding of £43 million but with strings attached that forced the IASB to allow interpretations of rules the EU Commission prefers. The threats to funding allowed the EU to avoid compliance and, after 10 years, warp some of the rules within the IASB to be more favorable to the EU.

At the supranational level agencies were directed to ignore purposeful noncompliance with IASB rules that may hurt EU firms. In 2011, the EU Commission directed the ESMA to give "special consideration" to firms suffering from bond losses after the financial crisis. In effect,

[78] The threats to funding, which started in 2010 with statements from E.U. internal market commissioner Michel Barnier were reported initially by the Financial Times but were also reported as early as 2009 by Zeff & Camfferman (2015): http://www.ft.com/cms/s/0/8fc6ab2e-404a-11df-8d23-00144feabdc0.html

this meant firms did not need to comply with international standards since there the EU would not enforce the IASB's interpretation. This was especially visible in Greece[79] with the ESMA avoiding penalizing actions (i.e. fines) against firms and instead advising firms how they may comply better with international rules. In the years following the crisis, enforcement actions across the EU dropped by 33%[80] for all international accounting laws (Maloney 2014).

With a lack of supranational enforcement of international rules, individual countries' enforcement agencies, which report to the ESMA in the EU, had to decide what levels of compliance were good enough. Some countries in the EU, such as Finland, with independent private standard setters and enforcement agencies maintained high levels of compliance and zero interference from their respective governments. Other countries, such as Greece, used government institutions to avoid compliance with international regulatory law.

For example, in 2010 to help mitigate its economic crisis, the Greek government created the Hellenic Financial Stability Fund (HFSF) as a private entity separate from the government. This legal entity's purpose was to manage banks with nonperforming loans (i.e. defaulted debts) and to provide capital when necessary. However, while the HFSF is an independent organization, the law that created and governs its actions explicitly is in noncompliance with international financial law. For example, in its August 2013 report about its use of IFRS, the HFSF noted the financial rules that govern it used old interpretations of IFRS (from 2009).

[79] The ESMA did not officially form until 2011. Most sources, including the ESMA reports, put their enforcement actions in these early years around 30 for the entire EU with 4 or 5 cases with some actual legal action taken. While some Greek firms likely suffered from the ESMA after the crisis, none of them suffered from the IASB 39 rules even if they were not in compliance due to "special consideration". This is the main point that is important here.
[80] This number comes from a joint CESR and ESMA Report.

Additionally, the HFSF used the same noncompliant interpretations of regulatory rules as the EU Commission despite opposition from the IASB.

The US Path toward Compliance and "Condorsement"

In 2002, the US standard setter (FASB) committed to eventually use (cooperate) and comply with IFRS via the Norwalk agreement with the IASB. This was during a time when US financial trust had deteriorated due to accounting scandals. The FASB most likely choose IFRS since US had lost substantial influence on standards. For example, New Zealand and Australia stated in a joint government report that their move to IFRS in 2005 was motivated by Enron and Worldcomm scandals in the US. This lead to the FASB, likely believing the US would not be the leader in financial rules, signing the Norwalk agreement. In this way, the US would at least have some voice in the future of the IASB (and in effect international rule making).

In the years and meetings after, the FASB with the IASB developed a path that would allow the US to both adopt and comply with international standards (i.e. IFRS) and slowly cooperate with all rules.[81] In the initial iterations of the FASB's plans with the IASB, endorsement as a mechanism to delay rules or reinterpret them was considered (similar to the EU's endorsement mechanism). Plans changed slightly with the passage of the Emergency Economic Stabilization Act in 2007. This act gave the SEC the power to stop convergence and coined a new term for future cooperation and compliance called "condorsement".

[81] For the sanity of the reader, I have omitted the technical details here and I have little interest in discussing them because they do not add to the political discussion. However, for those interested at a technical level what compliance would look like for the US, there are thousands of pages of transcripts from the 2002-2008 meetings between the IASB and FASB on the FASB's website.

Condorsement, a term invented in 2010 by SEC Deputy Chief Accountant Paul Beswick, describes the SEC policy that instead of simply implementing rules and changes in a timely fashion in conjunction with the IASB, the FASB would endorse (interpret, delay, and choose compliance) and also maintain an entirely separate set of US standards US firms could use. This is more than just rule carves-outs (partial cooperation) or different rules for some firms or sectors, but instead an entirely parallel set of rules for firms anywhere in the US. In the long run, the FASB would make US rules slowly converge to IFRS despite numerous areas that are discontinuous and difficult to adjudicate.

While the US was not actively requiring IFRS for firms during this time, many firms in the US are permitted to file separate reports using international rules. Thus, because of changes by US congress and modifications to the FASB's plans by the SEC, the FASB could no longer comply with international regulatory agreements in a way it desired. Instead, US actions opened the door for each rule to reinterpreted, delayed, or rejected. Condorsement may protect sovereignty but it defeats the purpose of international regulatory agreements and renders them less useful.

New Zealand, Canada, and Independent Rulemakers

Although New Zealand's compliance with international regulatory agreements is not perfect, it has one of the highest IFRS compliance rates in the world. In part, this is because compliance with international accounting rules and their implementation is the responsibility of an independent body. Furthermore, this independence is codified into New Zealand law

(Financial Reporting Act of 2011[82] and the former Financial Reporting Act of 1993). In fact, IFRS rules become law almost immediately even if the New Zealand Parliament subsequently disallows them (Cammfermann & Zeff 2015). New Zealand's two accounting laws work together to allow its independent External Reporting Board to make IASB rules and amendments into law as soon as they are announced.

Unlike the political endorsement boards in the EU or the US, New Zealand's board consists of accountants and has international cooperation as a chief goal. For example, the EU Commission must consider how each rule helps EU countries before deciding to endorse it, reinterpret it, or reject it. New Zealand, on the other hand, pursues a strategy of working the with IASB in formal meetings to promote new IFRS rules that are in the best interest of New Zealand. This cooperation takes place among technical experts and not politically appointed members.

Free from political interference with international rules, firms in New Zealand have an advantage with compliance. New Zealand and in other countries with independent standards boards[83] can be certain of how future regulation and the compliance requirements since there is less chance of legislative acts or threats to agency funding that will alter accounting rules and compliance expectations. In contrast, in the EU, after the EU Commission takes an endorsement action, compliance decisions, for the most part, are in the hands of individual countries'

[82] In Cammfferman & Zeff's (2015) research they state this law passed in 2011. However, the External Reporting Board (in New Zealand) cites the 2013 law.
[83] Or endorsement committees. They tend to be tied to each other except in the EU where the endorsement board is explicitly the EU Commission, but countries also have their own accounting standards boards as well and enforcement agencies.

standards boards or agencies. This adds complexity to compliance with international financial agreements that New Zealand is able to avoid.

Similarly, Canada's standard setting board (AcSB), which is responsible for endorsement of new international rules, is completely independent of government. It voluntarily has a few former members of government on its oversight committee, but otherwise consists of experts working with the IASB. Although Canada's complete compliance rate is unknown, the country was free from large compliance issues with the IASB (during its negotiation process and gradual adoption of IFRS). Furthermore, firms are able to write on their reports "IFRS as understood as the IASB" because the Canada standard setter has faith in its ability to comply with current and future international regulations.

In part, Canada's AcSB may have had more success in international compliance because its agreement with the IASB completed circumvented any government oversight. For example, as part of its agreement[84] with the IASB, the AcSB provides feedback as new international rules are developed and provides technical expertise. This is in contrast to other countries or endorsement committees such as the EU Commission that try to influence the IASB's international regulations through delays, funding threats, and other avenues of political pressure.

This independence avoided the compliance issues present during the US and EU's "accounting standards war" that followed 2008. Rather than fight the IASB or look for short-

[84] Here I am referring to the 2006 Best Practice: Working Relationships between the IASB Board and other Accounting Standard-Setters. The IASB's Canada report 2015 emphasizes this working relationship.

term gains, these agencies worked with the IASB to avoid compliance issues. Furthermore, by avoiding obfuscation of standards through compliance, these regulators were able to maintain transparency.

Stability Over Transparency

Within these cases, the countries with political control over their standards boards were able to bend compliance for more opaque financial reporting. The actions hindering compliance were done purposely in the name of stability. Noncompliance for stability was an issue as early as 2004 when Sarkozy (then Minister of Finance) stated changing IFRS would stabilize the EU economy. Similarly, the SEC's actions in the US hurt prospects for both compliance and cooperation on international rules after the financial crisis. Until 2008, the US standards board (and future endorsement board) were politically independent and received their funding from nongovernmental sources.

Implicitly in this chapter, and as stated by Hans Hoogervorst, the existence of an endorsement body also signals that countries are concerned about their sovereignty regarding transparency of their domestic firms. New Zealand, Canada, the US, and EU all have endorsement committees so there must be some concern over future rules from the IASB. Despite sovereignty issues, New Zealand and Canada are confident enough to leave the compliance process in private hands. All four countries have a long history of standards boards and development, yet the US and EU do no trust private bodies to act in their national interest.

In the context of Cooperation and Coordination

The decisions within Canada and New Zealand to maintain the political independence of compliance bodies were not in a vacuum. New Zealand has a small level of partial cooperation while Canada has a small level of partial cooperation. These countries both locked in their disagreements with the IASB at the inception of IFRS and in turn there was less need for government intervention via compliance. This has most likely aided the independence of endorsement bodies in Canada and New Zealand.

Early cooperation and coordination carve-outs do not necessarily mean a country will have politically independent endorsement boards (chapter 5 discusses this topic more thoroughly). These early carve-outs may create less of a need for endorsement boards and less extreme partial cooperation or coordination. Noncompliance is, in most instances, more useful as a tool for regulators and governments that need a short term solution to stability at the expense of an IFRS rule (i.e. transparency).

The EU Commission carved-out rules initially with the passing of the IFRS regulatory law in Europe (coordination carve-outs happened at the same time but mostly on a country to country basis in the EU). The question that must be asked is how much would noncompliance increase if these early cooperation and coordination carve-outs did not occur. The EU Commission clearly anticipated the IASB would move from the Commission's preference point and safeguarded against it by giving the Commission endorsement power. The more extreme measures, such as threatening the IASB's funding, may indicate the EU Commission did not anticipate that the preference point between the Commission and the IASB would diverge as much as it did during the financial crisis.

The US, with the intervention of the SEC, took the unprecedented route of creating "condorsement" so cooperation and compliance could be manipulated at any time. Under this system, compliance with IFRS and rule carve-outs can quickly change. This means initial level of cooperation will no longer be viewed as sticky if the SEC commission's condorsement body makes rapid changes (which they will have the power to do). The US path may be a product of watching the EU Commission struggle with maintaining control over its standards through mostly short-term measures of noncompliance.

Political Endorsement and Standards Boards

Political endorsement committees or standards boards are necessary for the failure of international compliance, but not sufficient in themselves. Some pressure to reinterpret the rules in a more favorable way must come from a domestic audience, and this is more likely to occur during times of extraordinary need (i.e. economic crises). When compliance is in the hands of political bodies, domestic pressure can be channeled in a way that international agreements (of a regulatory nature) are less meaningful. This should also be true for other international regulatory agreements such as the Basil Accords, which include international accounting standards, and other non-financial regulatory agreements such as internet rules in the World Wide Web Consortium (W3C).

Within the political science literature, this complements Alt et al. (2014) by demonstrating noncompliance is not simply about election cycles and that the national standards or endorsement body heavily influences international compliance. This means the analysis of international compliance around elections may benefit greatly by taking into

account if a political body is responsible for compliance or is the agency independent and full of technical experts.

In regards to Drezner's (2007) work on international regulatory compliance, the evidence in this chapter directly contradicts his theory that countries pursue regulatory agreements that reflect their regulatory status quo. Endorsement agencies and political standards boards are responsible for shifting international agreements when they are not favorable to a country's current political environment. The technical expertise for regulation makes understanding the status quo, especially by political leaders, difficult. This chapter only covers a subsection of international regulatory agreements (financial ones), and the evidence in these cases unequivocally demonstrates international regulation is often adopted when its far outside the status quo. This is also the case for more powerful countries such as the US or EU.

Authorities in the EU and US may believe there is too much power in a private organization that decides how their firms should disclose financial information. Controlling which rules are agreed to and where they apply, may not be enough for countries with large capital markets or countries that are more susceptible to economic shocks. It is possible countries like New Zealand and Canada leave compliance to independent agencies because they have less to lose in a crisis. However, these countries still maintain an endorsement process to filter new rules, unlike some countries (mostly in South America and Africa) with no endorsement body. Thus, it is also possible New Zealand and Canada believe their independent agencies will act in their best interest.

Like all international regulatory law or agreements, IFRS needs industry and technical experts to put it into action and ensure compliance, and these experts' function cannot be

easily replaced by political boards with short term economic goals (i.e. stability). Additionally, every country has slightly different bodies that are responsible for endorsement and standards, but in most cases it is easy to recognize when a board or committee is an extension of domestic politics. This may be more obvious in countries like Brazil when the country's president appoints the head of the compliance body or in the EU (because the EU Commission is also the endorsement body). Political boards typically have less experts with backgrounds in finance or accounting and on the aggregate are less likely to comply with international rules.

Independent organizations that build rules and have some responsibility to ensure compliance appear to be best related to successful international regulatory outcomes. From the countries examined, all struggled with compliance to varying degree except for New Zealand that had financial regulatory independence codified into law and Canada with its completely independent standards board. Once politics are introduced into international regulatory agreements, compliance may only occur in the best of circumstances.

Agency independence, however, does not solve the issues of cooperation and coordination discussed in the previous chapters. Canada, for example, still has not fully adopted all[85] IFRS rules though they are following a gradual plan of adoption. Canada also plans to exclude some firms from IFRS and still allows some businesses to use US rules if they wish. These moves were made in consultation with financial and industry experts. However, for the IFRS rules Canada's AcSB has adopted, there have been no notable compliance issues since adoption (around 2011). Likewise, New Zealand has also shielded some industries from IFRS

[85] The data here I refer to is from 2015. Supposedly, Canada will use all IFRS rules in 2017 and that is why various tables in this project show the country as a full cooperator.

and has a few cooperation issues[86] with how one international rule, regarding disclosures, applies to larger firms.

Finally, compliance data is not widely available and this creates issues for those studying the politics of international regulatory outcomes. Additionally, within the area of international regulation, there are varying bodies that build, coordinate, and comply with these rules, and there are a plethora of different issues covered. Regardless of issue area, these kinds of international agreements should still require some type of technical expertise or input from the private sector or private standards boards. The greatest successes, when politics do not enter international agreements, will garner less attention such as the W3C.

[86] Here, I am referring to the fact New Zealand has slightly different rules for large firms in terms of what must be disclosed.

Chapter 5

The Politics of International Regulatory Outcomes

"The objective, as much as possible, is one IFRS, but that's a lofty goal that cannot be achieved... We refer to [IFRS as issued by the IASB, EU, local, pre-MoU] as different flavors of IFRS"

-Margaret Smyth, IFRIC member (IASB Body), 2009

How should political scientists approach international regulatory agreements in regards to the three lenses of cooperation, coordination, and compliance I have presented in this project? From the financial regulations explored in this project, there is a meaningful and sequential way to analyze the way international agreements unfold. First, cooperation is typically carved out followed shortly after by coordination issues. Compliance issues, along with the endorsement possibilities, are introduced later. Within these stages, there are also several competing domestic interests influencing each. For example, foreign investment concerns and transparency influence cooperation while market development affects decisions about which firms in a country may use IFRS. Before discussing both sequence of analysis and which forces impact the political side of these agreements, it may be fruitful to explore previous explanations of the spread of regulatory standards, and how this project fits in the grander scheme of international relations theory.

Simmons (2001), in a similar manner to Drezner (2008), understood international regulatory growth as an expression of country power and capital markets. This would be true to an extent if all countries used the same standard, but IFRS comes in many flavors despite the wishes of the technical experts that create them. Their error, in part, was not analyzing the substance of these agreements (i.e. how they unfold and what they cover). This does not mean

that we need to understand every micro deviation from an international agreement or even understand completely the regulations covered in international agreements. It is only necessary to spot large gaps in cooperation. The gaps and differences in IFRS are big enough that countries such as India are accused by the IASB as only using IFRS in name. Recognizing these large gaps is important for understanding the politics of international regulatory agreements and avoids incorrect assessments such as those made by Simmons and Drezner. The lesson here is: Standards across countries using the same name may not be the same at all.

In contrast, Posner (2009) posited the politics of international financial regulation were an expression of specific events such as the scandals of Enron and WorldComm in the US. These events undoubtedly pushed countries away from US standards, and official statements from both Australia and New Zealand support his claims. However, much like Simmons and Drezner, Posner did not understand the different flavors of these international agreements and the economic and political implications behind large deviations. While events such as financial scandals in the US may explain IFRS broad growth, events such as the 2008 financial crisis explain IFRS is not a monolith and it is fragmented.

This fragmentation meant Abbot & Snidal labeled IFRS as a transactional standard (a subset of international regulatory types), but in some ways they were wrong about its status as a transactional standard. A transactional standard such as the metric system only works well when every actor uses the same definitions. Because of politics in the financial world, two countries using IFRS may in fact be measuring one million dollars of debt differently whereas under the metric system a meter is always a meter. To their credit, Abbot & Snidal correctly assess these types of standards are subject to distributional problems and IFRS has hundreds.

Buthe & Mattli (2005 & 2011) work on private standards boards captures how the lobbying process of firms may shape IFRS, but ignore the work done by governments that structures these international agreements. Furthermore, their work labels private standards boards for accounting and other organizations as the new "global rulers", yet this project rejects the notion that so much power is held in these organizations. At an international level, they mostly, as I have demonstrated, shape cooperation, coordination, and compliance with a heavy hand of government at each stage. These organizations are far more powerful than Drezner argues but still not as powerful as Buthe & Mattli posit in their work.

Finally, Fioretos (2010) argues that regulatory outcomes such as IFRS are the result of path dependence and market power of countries in a similar fashion to Simmons and Drezner. A closer examination of many countries, such as Greece and Romania shows this is untrue. For example, the foundations of accounting boards in these countries were built by communist regimes with incompatible rules. To explain their cooperation with the IASB on IFRS, a different approach is necessary. International and local politics have catapulted IFRS into countries to varying degrees where incompatible standards were once used. Furthermore, the market power argument is empirically false since US standards faltered.

Broader International Relations and this Project

In the grander scheme of international relations, in particular international cooperation, the lessons from this project are: (1) cooperation may be partial and asymmetric, and (2) most international regulatory agreements, especially those with economic impacts, will have several junctures with the possibility of failure. On the first note, implicitly, and sometimes explicitly in

the literature on international cooperation, the literature argues diffusion is mostly a positive process (Berry & Berry 2007; Dobin et al. 2007; Rogers 2003; Simmons & Elkins 2004; Weyland 2007). On the other hand, within this project I discuss how international standards are subject to backsliding or negative diffusion.

Cooperation

However, in this project and in chapter 2 in particular, I demonstrate cooperation sometimes takes an asymmetric form with backsliding. I believe this occurs with all international financial agreements from IFRS to the Basel Accords given the various ways capital rules can be carved out or even reinterpreted. Moreover, all financial rules (i.e. accounting) are political and subjective and this makes harmonious international agreements difficult. Beyond the politics of international finance, areas that require private standards committees, such as ISO standards, may also have ample opportunity to partially cooperate and carve-out rules. Future research may find it most fruitful to start with these kinds of agreements for evidence of partial cooperation, but it may also occur in formal international agreements that are not filtered through private technical boards.

This partial cooperation also fails to illicit retaliation from countries that may be harmed. This may be due how financial standards agreements bundle thousands of regulations together and even experts find it difficult to discern exact economic impact from each deviation. In addition, the amount gained for cooperating on just a partial set of rules is greater than the harm caused in most instances of partial cooperation. In contrast, an international

environmental agreement may have a few guidelines and a deviation will cause massive perceived harm to fully cooperating countries.

Furthermore, transparency from financial standards is an international public good. Every actor benefits when other actors are transparent and every actor is harmed when transparency is reduced. Countries cannot deny the benefits of their transparency to the countries that fail to cooperate, yet countries continue to fully cooperate in the face of partial cooperation of others. At the same time, no international agency can properly enforce either financial transparency and reporting rules. To maintain this public good, thousands of apolitical technical experts are required.

Coordination

Like cooperation, the outcome from coordination issues is asymmetric fulfillment of an international agreement. The reasons differ in the sense the coordination problem may be technical (i.e. lack of market development) though may have an economic motive (e.g. access to foreign credit). South Korea was motivated by access to capital from the World Bank and abroad but also likely applied IFRS selectively due to underdevelopment of some economic sectors. The technical reasons for partial fulfillment of an international agreement may only delay some sectors but not prevent full coordination in the long run.

Reciprocation of these regulatory agreements tends to occur in different sectors such as banks in one country and the extractive sector in another country. This may tell us international actors care more about the growth of standards with the hope they eventually become ubiquitous more than their universal immediate application. For long-term goals, organizations

responsible for regulatory law must believe in increasing harmony instead of the discord with IFRS type agreements. It may be the view that using 70% of the same standards is better than none at all.

IFRS used exclusively for the financial sector is a common coordination outcome and this is important since this sector threatens global stability the most. If most countries create more transparency in their financial sectors, there may be less incentive for organizations like the IASB to withhold support from partial coordinators. Thus, while retailers using IFRS may benefit everyone, transparency in the financial industry may also stop IASB from punishing partial coordination in the short term. Global public goods such as bank transparency may cause agreements to work even in the face of asymmetric efforts.

Compliance

The compliance issues are quite different than the cooperation and coordination problems and, in the grander sense, speak more to the arguments of central bank independence. How standards boards handle the financial reporting requirements of their international agreements is similar to the somewhat parallel literature on central banks from Alesina & Summers (1993) and Keefer & Stasavage (2003). In both instances, the political appointment or control over an institution harms the institutions' broad economic goals. The main difference is that I focus compliance whereas the central bank literature speaks more about domestic credibility.

Agency dependence must be combined with an external shock (e.g. election or economic crisis) for noncompliance, and this is supported by findings from Alt et al. 2014.

International regulatory agreements must have a domestic impetus for deviation, and sometimes this may also strip an independent agency of its independence. For example, the FASB of many powers post 2008 in the wake of the financial crisis. However, since these standards boards have only existed in the last sixty years, it is unclear if dependent agencies may become independent again in the future. There have been no reversals[87] of agency dependency.

Compliance is also dependent on the number of veto players with less in countries that maintain independent agencies. Threats to funding, political delay, and political interpretation of rules all create different junctures with veto players. Countries will continue to use political standards boards as long as the IASB lacks the power to enforce the public good of financial transparency.

International Standards: Not About Great Powers

As Drezner (2008) and Simmons (2001) posited regulatory outcomes tend to reflect great powers' preferences or their market power respectively, I must also address the EU's disproportionate role in IFRS. These rules originate from a private body in the EU and the EU was one of the earliest adopters of the regulations. However, in light of Drezner and Simmons, it is important to consider there are great disagreements between the IASB and EU Commission and the EU commission has not been successful in changing many IASB policies.

[87] In a very small way, New Zealand strengthened its already independent endorsement body (the body responsible for compliance) in 2011. Thus, agencies have become more independent or protected but have not made a complete switch from dependent to independent.

First, arguably the IASB has made only a few rules because of the EU. For example, the EU Commission's funding threat likely altered IAS 9 (discussed in chapter 4), and the IASB altered some rules to help Greece alleviate its crisis post 2008. For the most part, the EU Commission and EU states have been at odds with some IASB policies and this has led to rule carve outs and noncompliance. If the EU Commission truly shaped the regulatory decisions of the IASB, there would not be large deviations in policy. Financial reporting that indicates different versions of IFRS, such as the EU's version, would be eliminated. However, because the EU is the largest block of countries with the largest market to use IFRS, it is arguable that many of the rules developed have the EU market's interest in mind.

The causal arrow in explanations of Simmons and Drezner is in the wrong direction for many international rules. It is not that great powers such as the US or EU get to decide the rules, but rather private regulatory agencies make rules that may best fit these markets. The occurrence of entirely different and new rules at the request of the EU Commission occurs much less than rules created to fit the market by private agencies. Great powers, like the US and EU, partially cooperate or coordinate on rules as they receive them. Later, these same countries decide their compliance policies such as an endorsement board.

Finally, if power was the determining factor in the spread of international standards, this project would be dissecting the politics of US GAAP around the world (as Simmons predicted US GAAP would dominate after 2001). There are clearly other forces at play and the spread of IFRS and its politics go beyond simple calculations of international market power. All states utilizing IFRS seem to have a shared interest in promoting the global public good of transparency even if contributions toward this goal are uneven.

Through the Lenses

How should the lens of cooperation, coordination, and compliance be used together? First, these are not meant to be mutually exclusive ways of analyzing the politics of regulatory agreements. These forces may act together at the same time in a given country or only one issue such as cooperation may dominate. Second, in most cases these can be analyzed sequentially. Finally, some issues outside of broad international financial agreements may only be analyzed by one or two of the three lenses. For example, not every agreement will have coordination issues across industry since some agreements will only apply to one economic sector or set of firms. Additionally, the compliance lens may fail when an international agency has the power to enforce treaty obligations. Broadly, for international agreements that should[88] be in the hands of private regulators, these lenses should apply and also to some formal agreements (e.g. Basel Accords) that require technical experts for implementation.

Since compliance outcomes always follow cooperation and coordination, control over compliance will determine in part a country's cooperation and coordination strategy. In other words, anticipated compliance shapes how countries may carve-out rules or sectors in the initial agreement. I discuss this after cooperation and coordination below.

First Cooperation and Coordination

First it is useful to identify if the regulatory agreement is a public good with distributional problems. These types of agreements will be the most susceptible to partial

[88] I mean for agreements like IFRS that are supposed to be between private regulators, yet often governments and political intervention dominate how the agreements unfolds.

cooperation. A public good, such as the global financial stability of the Basel Accords, may be important enough for states to continue cooperation even in the face of partial cooperation (or backsliding) by other states. In most cases, these rule carve-outs for IFRS have manifested shortly after (within a year) of the initial agreement. In fact, shortly after its agreement with the IASB, the EU's regulatory law requiring IFRS had rule carve-outs written into it.

Next, can the distributional gains be divided? If so, there is more likely to be partial cooperation as countries move to capture extra gains by cheating on the margins. If not, there will either be full or no cooperation among signatories. Thus, if a regulatory agreement is a public good with distributional gains that can be divided, it may have a larger potential for partial cooperation that can be identified in an early stage. This partial cooperation may be present as legislation or as rules by private boards that nullify parts of an international agreement. Furthermore, coordination problems can exist independent of the result of partial cooperation.

International coordination issues tend to develop sometime after rule carve-outs when the final rules are known. Industries are commonly excluded with the promise of being integrated later. For example, almost all IFRS agreements contain language of a gradual phase in of private firms in the future.[89] Also common in agreements is specific language excluding banks or insurance (i.e. the industries that are impacted the most) for 3 to 5 years. For example, Brazil gradually phased in its banks after a 3-year period and Greece phased in financial institutions during a 5-year period.

[89] Despite promises, most countries continue to develop parallel systems of accounting standards. One for the private firms and one for public companies. In the long run, this means there will continue to be divergence in standards.

The key question to ask for coordination is: what industries will an international regulatory agreement impact? When the broad economy is effected, it is more likely coordination issues will develop with specific firms claiming they should be exempt. On the other hand, more specific agreements, like the Basel Accords, should be more successful since exempting an industry would nullify the agreement entirely.

A small subset of countries, such as South Korea, may appear to develop their level of cooperation and coordination at the same time. However, in South Korea's process, it was not until the level of cooperation was decided that the government meet with lobbyist, the private standards board, and technical experts to discuss which firms should be excluded from the agreement. Still a small set of rule carve-outs may develop later (typically through legislation) and coordination issues may arise years later as firms fail to transition or lobby against a transition.

The problem with standards is the total number is meaningless. This is because one standard can have more economic and financial impact than 10 other standards. It is about the quality and not the quantity. Thus, the small number of cooperation and coordination issues that may develop later may be more impactful than those that existed at the inception of IFRS. However, on the aggregate, a larger number of cooperation issues occur at the start of an agreement and these are followed by coordination issues.

Compliance Shaped by Cooperation and Coordination

In terms of regulatory agreements, the types of compliance issues I have outlined will only occur when private bodies responsible for interpreting, disseminating, and, to a lesser

extent, enforcing the rules are beholden to a political process. This assertion is also demonstrated by Art et al (2014) for elections in terms of compliance with IFRS. When governments maintain political control over standards boards, there is less of a necessity to interfere with cooperation or coordination at the onset of IFRS. Noncompliance is mostly used as a temporary fix for economic maladies and it is unclear if it is an effective long-term political solution to the perceived negative side effects of standards (e.g. when there is disagreement about valuation of debt like in Greece).

For countries with political control over the compliance process, the key questions are: (1) is noncompliance shielding a particular sector or set of firms (coordination issues) or (2) is it protecting FDI inflows by ignoring or reinterpreting rules (cooperation issues), and (3) is it temporary noncompliance with the goal of stability over transparency (this is the main use of noncompliance). The first two questions help determine if a country is fully cooperating or coordinating in the long run and have utilized compliance to tackle issues of cooperation and coordination in the short-run.

Short-run noncompliance can also be used without a nefarious motive. For example, endorsement boards typically ask for clarification or how they should apply a new IFRS rule and sometimes it may take IFRIC a year to settle disputes. While this is common, it also easy to identify situations where endorsement boards have abused this power such as the EU Commission when it delayed IAS 9 by over 10 years. An EU Commission with perfect information would have likely used cooperation carve-outs at the inception of IFRS to avoid the IAS 9 situation, but instead was forced to utilize its enforcement power.

For the countries that did not create a noncompliance mechanism (an endorsement body) at the start of IFRS, there have been no moves to introduce such a mechanism. This may mean these countries locked in divergent policies at the start of IFRS and these were large enough to negate the need for a noncompliance mechanism. India, for example, has such severe cooperation and coordination carve-outs that the IASB has questioned its use of the name IFRS, but, at the same time, India has no endorsement body. India's finance minister and parliament may believe the carve-outs at inception will stave off the need for a noncompliance mechanism in the future. On the other hand, Argentina has not carved-out any IFRS rules, yet regulators maintain an endorsement mechanism to change compliance in the short-run with any rules that may not benefit Argentina.

Final Thoughts on Compliance

Thus, especially when examining the politics of financial regulatory agreements, it is important to note how cooperation and coordination are mitigated in an initial agreement and how noncompliance mechanisms can be used to achieve similar goals to partial cooperation and partial coordination. Typically, countries[90] without noncompliance mechanisms are the greatest users of partial cooperation and coordination, and countries with noncompliance mechanisms carve-out less rules and industries from their initial agreements.

In this project, I have not made an effort to demonstrate systemically the exact impact of each rule carve-out or issue of noncompliance. This is extremely difficult, even for experts, to

[90] While the data to thoroughly test this does not exist, in the countries that are investigated in this project (chapter 4 and elsewhere) this clearly seems to be a trend.

measure. Such analysis is beyond the scope of this project, yet for the countries analyzed noncompliance tends to be much more severe when rule carve-outs were not deep or were nonexistent at the inception of IFRS.

Despite all the paths possible to mitigate the requirements of an international regulatory agreement , many countries such as Qatar, Ghana, and Costa Rica[91] continue to be free of any cooperation, coordination, or compliance issues. Thus, there are many countries that mostly adhere to the rules. Within the countries with deviations, such as Brazil or China, most rules are still the same as their internationally counterparts. The problems discussed in this project broadly focus on larger carve-outs and deviations, which are incredibly impactful to international businesses and investors, and these deviations are due to political forces. These deviations do not necessarily mean that IFRS are entirely useless since some rules are still followed.

All Accounting is Political

For as much of this project that speaks to the failures of international financial standards, globally the adoption of IFRS has been increasing and most rules are adopted without disagreement. The transparency and international comparability of firms, which stems from IFRS, is a public good that benefits global economy. However, under a microscope there are several cracks within standards that upset convergence. The countries within the EU, for

[91] Technically, Costa Rica excludes banks from IFRS, but most of the agreement remains intact and there is no mechanism for noncompliance.

example, are supposed to use all the same rules, yet there is a plethora of differences from country to country (See Table 1.1 or Table 4.2 for examples).

The mechanisms for divergence with the IASB will continue to be different, yet the motivations for divergence will always be for economic gain. This is inherent in any standard that is subjective and open to interpretation. The politics of accounting are far worse than other regulatory standards since they have the power to change value of firms, obscure transparency, and benefit (even if temporary) economies. Furthermore, few countries have managed to keep accounting entirely independent of politics.

Scandals such as WorldCom and Enron ignited a debate surrounding the use of US GAAP (both within the US and abroad). Scandals such as these are the rare moments that the public eye briefly catches a glimpse of how much accounting rules can impact the economy. These two scandals were also cited by New Zealand and Australia in their government reports to move to IFRS. Without a better strategy to mitigate political pressure from the EU Commission, the IASB may find IFRS in a similar position to US GAAP with lost confidence and possible scandals. The moves made to lessen Greek debt through IFRS (via the EU Commission) were arguably far worse than any US accounting scandal.

The type of deviations that exist within IFRS agreements will be important to consider in any study that tackles international agreements that require some type of private body to negotiate, implement, or interpret. Buthe & Mattli (2011) may have overstated the importance of these new types of agreements and regulators, but they were correct in their argument that they will continue to grow and cover more government functions. In part, this is due to the fact governments often lack the technical expertise to deal with problems such as financial

reporting or ISO standards. This trend will continue in the financial reporting world as the global economy grows and as new financial instruments and creative accounting is born.

Down the Rabbit Hole of International Regulatory Outcomes

The goal of this project is to explore why international regulatory outcomes concerned with finance are so fragmented and subject to backsliding, yet I have only examined a small subset of political problems with international accounting standards. Other scholars have spoken to the politics of IFRS spread (Abbot & Snidal 2001, Buthe & Mattli 2011, Simmons 2001, Poser 2006, Posner 2010, Porter 2014), but outside of this project no one[92] answered why the international regulatory outcomes with IFRS are so diverse and lead to negative diffusion. With increased changes in the last decade, it is unclear when or if fragmentation will stop within international financial standards.

Brexit, which is still ongoing at the time of this project, is expected to have serious implications for the growth and future of the IASB. While IASB headquarters are located in London, the Financial Review Council (Britain's private regulator) is expected[93] to change many financial reporting regulations. It is doubtful Britain's exit from IFRS will cause a cascade of countries dropping the standards, but it is possible Britain may develop a new path that

[92] Hail et al. 2010 discuss potential future scenarios and how US politics plays into potential fragmentation with US IFRS use, but I have yet to see a paper that approaches fragmentation internationally as I have here.

[93] Win Bischoff, chairman of the FRC, claims the UK will stay (as of May 2017). However, the UK government has already developed a plan to decide new reforms and potentially change the FRC.

countries will follow in the future that is independent of the IASB. However, this is still only a small concern.

Future work would benefit from analyzing the fragmentation and backsliding in other international regulatory agreements outside of the finance world. The problem in analyzing the political processes of rules like ISO standards is there may not exist expert bodies (such as the big four accounting firms here) that help define things such as partial cooperation. For this project, a deep understanding of accounting was necessary, but I was also aided by Deloitte and other expert bodies that publically make information available about partial cooperation, coordination, and compliance. Thus, research on other regulatory agreements may require enormous investment in regards to learning the regulations and the time needed to classify agreements (in the sense of partial cooperation, coordination, and compliance).

From this project, the main takeaway should be that seemly technical standards can be intensely political, and partial cooperation with negative diffusion and backsliding is common in these types of international standards. The political interpretations of value hinder standards' global use and the benefits countries could gain. Benefits can be squandered in different ways depending on the route a country takes to adopt IFRS. The unique issues within cooperation, coordination, and compliance threaten to make international financial standards meaningless in the long-run.

Lastly, as stated in the introduction, standards are more similar now than at any other time in history. I made no precise effort nor do I think it is possible to predict the future of standards harmonization. All evidence suggests standards have already begun to break down to an extent. Countries like India, which may only use IFRS in name, may be the worst offenders at

the moment. How the IASB or any future organization can prevent fragmentation is beyond the scope of this paper. If fragmentation continues, a new standard will replace IFRS just as IFRS replaced US GAAP in the early 2000s. Understanding IFRS failures lends new insight in the area of diffusion literature and other areas of international relations. These issues are also policy relevant to a small extent. As global finance continues to change, these core challenges facing IFRS will continue to be as critical as they have been for the last 60 years in the world of international accounting.

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